

## Background – KPMG illicit tobacco report 2017

- KPMG's Illicit Tobacco in Australia Report, commissioned by Phillip Morris and Imperial Tobacco, estimates that illicit tobacco cost the Government around \$1.91 billion in forgone revenue in 2017.
- The estimate is of a similar magnitude to recent KPMG estimates of the size of the illicit tobacco market.
- According to the KPMG Report:
  - Total consumption of illicit tobacco declined by 1.0 per cent. However, this represents an increase in the proportion of illicit consumption because legal consumption decreased by around 6 per cent.
  - Contraband consumption accounted for the majority of total illicit tobacco consumption at 51.1 per cent of the total. Contraband refers to cigarettes manufactured legally outside of Australia and smuggled into the country.
- Key quote: "We believe there is no denying the link between high excise and the illicit market. As excise on tobacco contributes to increased prices, the attractiveness of the illicit market becomes even more obvious to serious and organised crime".

## Defensive talking points

### *Impact of excise on the size of the illicit market*

- The illicit market is driven by a multitude of factors of which the excise duty rate is only one.
- Tobacco excise is among the most effective interventions to reduce the prevalence of smoking and protect the health of Australians.
- Australia's tobacco excise rates are below the World Health Organisation's recommended level. As of 1 September 2017, tobacco excise was estimated to account for between 53 and 62 per cent of the retail price of manufactured cigarettes compared with the WHO's recommendation of 70 per cent.

### *Difference between the Government's estimate and the KPMG report*

- The ATO and Home Affairs estimate of the revenue impact of illicit tobacco is approximately \$600 million per year.
- Though this estimate is significantly lower than the KPMG estimate, any loss of revenue is a serious issue and even more so given the involvement of organised crime in the illicit tobacco market.
- The estimates by the ATO and Home Affairs are based on extensive and high quality data held by these agencies, and use a methodology endorsed by independent experts.
  - The supply-side methodology used by the ATO and Home Affairs has been endorsed by an independent expert panel, comprising: Professor Neil Warren (Professor of Taxation at the University of New South Wales), Mr Richard Highfield (Adjunct Professor with the School of Taxation and Business at the University of New South Wales) and Mr Saul Eslake (Vice Chancellor's fellows at the University of Tasmania).

- Some aspects of the KMPG methodology are considered to be prone to variance such as:
  - The use of empty packet analysis, as it is impossible to estimate and adjust for legitimate overseas imports and the duty free allowance for international air passengers.
  - Questionnaires and surveys suffer from misinterpretation and error.
- Notwithstanding the difference in estimates, the Government agrees that a coordinated strategy is needed to combat illicit tobacco. That is why we are introducing a comprehensive illicit tobacco package, including the creation of the Illicit Tobacco Taskforce, which will combine the resources and capabilities of a number of law enforcement and border security agencies.

## BACK POCKET BRIEF – Illicit tobacco

### Budget measures

#### 2018-19 Budget measures (BP2 pg. 12)

- From 1 July 2019, tobacco importers will be required to pay excise when tobacco enters the country, rather than when it enters the domestic market, eliminating leakage from warehouses to the black market.
- From 1 July 2018, a new multi-agency Illicit Tobacco Taskforce, led by the Australian Border Force (ABF).
  - The Taskforce will leverage whole-of-government capabilities and powers from multiple agencies to investigate, prosecute and ultimately dismantle the international organised crime groups responsible for a large part of the illicit tobacco trade.
- From 1 July 2018, the ATO will be provided with additional resources, including an additional six investigators, to fight domestic illicit tobacco crops.
- From 1 July 2019, permits will be required for all tobacco importations, assisting border officers to quickly and efficiently determine when an offence has been committed.
  - This will deter the trade in illicit tobacco by providing the ABF with new enforcement options to seize illicit tobacco and infringe its importers more easily.
- Beginning 2020-21, the ATO will upgrade and future-proof its excise and excise equivalent goods payment systems to replace the outdated paper lodgement system.
- Moving the tax point will **require legislation**.

#### 2017-18 Budget measures:

- **Consistent duty calculation** was introduced for cigars and ‘roll your own’ tobacco products.
  - The amendments ensure that cigarettes and ‘roll your own’ tobacco products receive comparable tax treatment.

#### 2016-17 Budget measures:

- **Increase in excise** on all tobacco by 12.5 per cent commenced on 1 September 2017, with three subsequent annual increases (until 2020).
- The Government agreed to **strengthen the legislative framework for illicit tobacco offences**. These will be implemented through two pieces of legislation:
  - The *Treasury Laws Amendment (Illicit Tobacco Offences)* Bill - introduced to the House of Representatives in February 2018, currently before the Senate.
  - The *Customs Amendment (Illicit Tobacco Offences)* Bill - introduced to the House of Representatives in March 2018.
- The new penalties provide enforcement officers, including the ABF, with strengthened enforcement measures to tackle the illicit tobacco trade.
- The changes will give ABF/ATO officers the tools to better target criminals who smuggle or grow illicit tobacco. It will also remove current obstacles to prosecution by providing officers with powers to enforce offences where the origin of the tobacco is unknown or difficult to prove.

Impact of excise on the illicit market

- The illicit market is driven by a multitude of factors of which the duty rate is only one.
- When costing increases to excise rates Treasury estimates the decline in demand for legal tobacco due to behavioural responses. This decline in demand includes, for example, a reduction in tax collections due to consumers deciding to quit smoking as well as consumers shifting to the illicit market.
- The exact amount that the illicit tobacco market contributes to the decline in demand cannot be separately identified from the overall estimate.

Excise collections

- Tobacco receipts for 2016-17 were \$10.45 billion. **(BP1: 5-17)**
- At the 2018-19 Budget tobacco receipts for 2017-18 were revised up by \$140 million (1.2 per cent) to \$11.5 billion, reflecting stronger than expected collections since MYEFO. **(BP1: 5 – 15)**

## Illicit tobacco – Questions and Answers

Illicit tobacco – Questions and Answers .....	1
1. <i>What is illicit tobacco?</i> .....	2
2. <i>Why is illicit tobacco a problem?</i> .....	2
3. <i>What is the Government doing to combat illicit tobacco?</i> .....	2
4. <i>What is the budget impact of the package?</i> .....	3
5. <i>What is the tobacco Tax Gap? How does it compare with the budget estimates?</i> .....	3
Collecting tobacco duties and taxes at the border.....	4
6. <i>What is the previous taxing process?</i> .....	4
7. <i>What is warehouse leakage? How does it occur?</i> .....	4
8. <i>Is this a new tax on tobacco? Will this affect the price of tobacco?</i> .....	4
9. <i>How will this impact the cash flow of tobacco importers?</i> .....	4
10. <i>How did the Government prevent duty evasion ahead of the change in tax point?</i> .....	5
11. <i>What impact will this have on the underbond warehousing industry?</i> .....	5
12. <i>What consultation was undertaken with the industry?</i> .....	5
The Taskforce and Permits System .....	6
13. <i>How does the permit system work?</i> .....	6
14. <i>What are the Illicit Tobacco Task Force’s capabilities and powers?</i> .....	6
15. <i>What is the impact on tobacconists, duty free stores and other small retailers/consumers?</i> .....	6
16. <i>What is the Government doing to address the delays in refunds and drawbacks for tobacco under the new arrangements?</i> .....	6
Background.....	7
17. <i>Overview of the tobacco importing industry.</i> .....	7
18. <i>What are the different tobacco types?</i> .....	7
19. <i>How much revenue is raised through tobacco duty?</i> .....	7
20. <i>What are the current excise rates for tobacco?</i> .....	7
21. <i>How is the 12.5 per cent applied?</i> .....	8
22. <i>What is the price of a pack of cigarettes, and how much is excise?</i> .....	8
23. <i>Is the illicit tobacco market a result of higher excise rates?</i> .....	8
24. <i>Reasons for tobacco excise (and are our tobacco taxes too high?)</i> .....	8
25. <i>Who has jurisdiction for combatting illicit tobacco?</i> .....	9
26. <i>What are the new offences in the Illicit Tobacco Offences legislation?</i> .....	9
27. <i>Why is the Government not actioning the Black Economy Taskforce recommendation regarding track-and-trace, as noted in a recent World Bank report?</i> .....	10
28. <i>Potential registration of tobacco license holders on a public register.</i> .....	10
29. <i>KPMG ‘Illicit Tobacco in Australia’ Report 2018.</i> .....	11
30. <i>Why is the Government not actioning the Black Economy Taskforce recommendation to reduce taxes and duties on molasses tobacco (shisha)?</i> .....	11

## 1. What is illicit tobacco?

Tobacco in Australia must satisfy health regulations and tobacco importers must pay duty. Illicit tobacco has avoided these requirements and is sold to consumers through the black market.

Currently there is no legal tobacco manufacture occurring in Australia and, since 2008, no-one is licensed to grow tobacco for commercial sale or personal use.

## 2. Why is illicit tobacco a problem?

Illicit tobacco is a key source of funding for organised crime and undermines Government efforts to improve public health outcomes by reducing the prevalence of smoking.

Law enforcement agencies have indicated that the illicit tobacco market is dominated by organised crime groups, which use tobacco profits to fund their other criminal activities. Organised crime will continue to operate and potentially expand if the Government does not increase resources for combatting illicit tobacco.

Illicit tobacco undermines the Government's harm prevention efforts by providing access to tobacco at significantly cheaper prices compared with legitimate retail sales and in some cases in counterfeit branded rather than plain packaging.

Based on ATO and Department of Home Affairs research, illicit tobacco results in almost \$600 million of forgone tobacco duty each year. The sale of illicit tobacco also reduces tobacco sales for legitimate retailers.

## 3. What is the Government doing to combat illicit tobacco?

The Government has implemented its Black Economy Package – combatting illicit tobacco measure announced in the 2018-19 Budget, which consists of five interconnected elements that target the three key sources of illicit tobacco in Australia: smuggling; leakage from warehouses and domestic tobacco crops.

### Tobacco smuggling

The Government has funded an **Illicit Tobacco Task Force** from 1 July 2018. The multi-agency Task Force has a full array of powers to effectively investigate, prosecute and ultimately dismantle the international organised crime groups responsible for a large part of the illicit tobacco trade.

The Government has also introduced a **prohibited import control for tobacco**. Since 1 July 2019, permits have been required for all tobacco importations, assisting border officers to quickly and efficiently determine when an offence has been committed. It will no longer be necessary to prove concealment of tobacco and intent to evade duty.

### Leakage from warehouses

Since 1 July 2019, importers have been required to **pay all duty liabilities upon importation**. Duties were previously paid when the tobacco leaves a licensed warehouse for the domestic market. This created a risk that criminals may seek to obtain untaxed tobacco via leakage from a warehouse before duty is paid. Moving the tax point has eliminated warehouse leakage by incentivising importers to maintain the integrity of the tobacco storage system and ensure the right amount of duty is paid based on the total amount of tobacco imported.

On **25 October 2018** Royal Assent was received of Customs Amendment ((Collecting Tobacco Duties at the Border) Bill 2018), moving taxing point for imported tobacco to the border from 01 July 2019.

## Domestic tobacco

The Government has funded the ATO to **combat domestic tobacco crops** (\$8.8 million from 2018-19 to 2021-22). From 1 July 2018, the Government strengthened ATO enforcement capabilities, including by adding an additional six investigators, to tackle domestic illicit tobacco crops. This is allowing the ATO to undertake additional activity to detect and destroy illicit tobacco and undertake follow up criminal investigations.

The ATO will upgrade and future-proof its **excise and excise equivalent goods\* payment systems** beginning 2020-21 to replace the outdated paper lodgement system.

\*Excise equivalent goods are imported goods – in this case tobacco – that are subject to customs duty at a rate equivalent to excise duty to ensure they're treated consistently with goods manufactured in Australia.

On **29 November 2018**, Royal Assent was received of Treasury Laws Amendment ((Black Economy Taskforce Measures No. 2) Bill 2018) and Excise Tariff Amendment ((Collecting Tobacco Duties at Manufacture) Bill 2018) moving taxing point for domestically manufactured tobacco (NB there is no domestic manufacturing).

### 4. What is the budget impact of the package?

The Package is estimated to generate a gain to budget of about \$3.6 billion from 2018-19 to 2021-22, including an increase in revenue of about \$3.7 billion offset by an increase in payments of about \$150 million.

Of the \$3.7 billion revenue gain, most of the \$3.3 billion in 2019-20 arises because of a change in the time that tobacco excise is paid (ie. shifting the taxing point to the point of importation).

This largely reflects a one-off boost to revenue in the first year of the measure as all stock held in warehouses as at 1 July 2019 becomes liable for duty and, at the same time, revenue is received from new tobacco imports due to the earlier taxing point.

### 5. What is the tobacco Tax Gap? How does it compare with the budget estimates?

The 2015-16 net Tax Gap for tobacco was \$594 million.

The Treasury costing and the tax gap estimate vary as they measure different things.

The ATO tax gap estimate is a theoretical estimate of how much revenue would be raised if all illegal tobacco were to be taxed in 2015-16. The Budget estimate is what will happen in the real world as a result of the policy changes announced by the Government.

A key difference is that tax gap estimates don't estimate how effective any policy will be at reducing illegal tobacco. The Budget estimates recognise that the criminal gangs behind illicit tobacco are sophisticated and well-resourced, and it would be misleading to assume that this package will shut down the entire illicit tobacco market overnight.

A second key difference is that tax gap estimates don't include any behavioural responses, such as reduced smoking due to significant price increases as illegal tobacco is taken off the market. Nor do they include the increased enforcement costs of closing the gap.

## Collecting tobacco duties and taxes at the border

### 6. What is the previous taxing process?

Previously, tobacco was imported by tobacco companies and stored in bonded warehouses. A bonded warehouse was one licenced by the ATO to store Excise Equivalent Goods (in this case tobacco) before excise was paid.

Duty was paid in weekly instalments based on the amount of tobacco that had left the underbond warehouse system and entered the domestic market.

### 7. What is warehouse leakage? How does it occur?

Warehouse leakage was the unauthorised or illegal removal of tobacco from a storage warehouse prior to the payment of applicable taxes such as excise.

According to DHA and ATO estimates, approximately 250 tonnes of tobacco in licensed warehouses was unaccounted for in 2015-16, and around \$172 million of tobacco duty was lost through leakage from the warehouse system.

Conducting compliance activity to combat this behaviour was extremely difficult as large volumes of tobacco was transferred between networks of licensed warehouses, obscuring the gap between the volume of tobacco on which tax had been paid and the volume that was imported. Criminal gangs were suspected of exploiting these weaknesses to steal tobacco.

Moving the taxing point to when the tobacco enters the country and imposing a permit system should stem this leakage. This puts the onus on the tobacco importers to ensure that the tobacco is secure as tax has already been paid. Any loss of tobacco effectively becomes a loss to the importer.

### 8. Is this a new tax on tobacco? Will this affect the price of tobacco?

No. This measure does not increase the amount of tobacco duty that importers must pay. It moved the tax point from when tobacco enters the domestic market for consumption to when it enters the country. This will prevent leakage of illicit tobacco from warehouses.

Prices may increase separately in line with standard six monthly changes to tobacco excise and already legislated tobacco excise increases on 1 September 2020.

### 9. How will this impact the cash flow of tobacco importers?

Importers are now required to pay tobacco duties at the point of importation, earlier than under the current system and in advance of the point of sale.

The measure has a one-off impact on importers as tobacco held in warehouses as at 1 July 2019 will be liable for tax at that time rather than when it enters the domestic market.

There were four broad options to enable tobacco companies to meet their excise liabilities as at 1 July 2019:

1. Reduce the likely inventory outstanding, by not replacing existing stock in warehouses as it was sold, or for aged stock that is at risk of being unsaleable, applying to have it securely destroyed.
2. Start paying duties on imports prior to 1 July 2019, to smooth the cash flow impact across the financial years.



3. Import produce closer to when it is required by customers ('just in time'), such as by importing smaller quantities or staggering deliveries, and holding stock in countries closer to Australia until needed by a customer.

4. Participate in the transitional arrangements.

To smooth the transitional impact on cash-flow, tobacco importers who are eligible to participate in the transitional arrangements are able to pay the outstanding duties in 12 equal instalments over 12 months to Home Affairs, on the basis they have provided an up-front financial security, and make the final payment by 30 June 2020.

The size of the security was determined based on a risk assessment made by the ATO and DHA, and ranges from 25 per cent for small importers to 100 per cent. For small tobacco importers, the security was capped at up to 25 per cent of the liability outstanding on the stock on hand at 30 June 2019, as part of negotiations with Senators to secure the passage of the relevant legislation.

All tobacco importers participating in the transitional arrangements had to make sure their income tax, GST and customs returns and remittances were up to date by 1 June 2019.

### **10. How did the Government prevent duty evasion ahead of the change in tax point?**

The ATO and Australian Border Force conducted stocktakes and reconciled warehoused tobacco prior to 1 July 2019. This ensured an accurate calculation of tax and duty liability for warehoused stock as at 30 June 2019.

The ATO also cancelled permissions for the movement of warehoused tobacco for some warehouses prior to 1 July 2019 to ensure the integrity of the stocktakes. (Movement permissions allowed importers to move tobacco between warehouses without incurring a duty liability.)

### **11. What impact will this have on the underbond warehousing industry?**

As tobacco is a perishable product and has a limited shelf-life, tobacco importers will need to continue to import tobacco and have sufficient stock at hand, in warehouses, in order to meet ongoing demand.

The package means less red-tape for warehouses because duty will already have been paid and so they will no longer be subject to duty control measures.

There have only been a small number of complaints from the warehousing industry, mostly in relation to the measures' negative effect on cash-flow, which we are addressing through transitional arrangements.

### **12. What consultation was undertaken with the industry?**

The Government undertook public consultations from 8 August to 22 August 2018 on the Treasury and the Home Affairs' complementary exposure draft legislation. Consultation was conducted jointly between Treasury and Home Affairs.

Eleven submissions were received. The tobacco industry is broadly supportive. Some submissions raised concerns about the cash flow impact, which are being addressed through the transitional arrangements.

The non-confidential submissions have been published on the Treasury website.

## The Taskforce and Permits System

### 13. How does the permit system work?

Since 1 July 2019, all importers have been required to hold a permit to import tobacco. Importers can apply for a permit through the Department of Home Affairs. As processing applications may take some time, DHA has some flexibility to administer the system during the transitional period.

Permits are valid for set periods with importers required to renew their permits periodically. This allows enforcement agencies to ensure that importers are complying with their obligations under the permit system. A comprehensive consultation and communication campaign has been conducted to notify importers of the changes and their obligations.

### 14. What are the Illicit Tobacco Task Force's capabilities and powers?

There are three components to the Illicit Tobacco Task Force:

**Intelligence:** systems analysis and targeting organised crime syndicates to provide accurate information to operational teams.

**Enforcement:** operational teams to detect and seize illicit tobacco at the border and investigate organised crime using a coordinated multi-agency approach to disrupt supply chains.

**Prosecution:** the new offences enacted in August 2018 provide the task force with greater ability to prosecute illegal activity by establishing reasonable suspicion offenses and removing the requirement to prove origin.

### 15. What is the impact on tobacconists, duty free stores and other small retailers/consumers?

Approximately 97 per cent of tobacco entering Australia reflects three main importers.

Most tobacconists and other small-scale retailers and consumers are not affected because they purchase tobacco from another importer rather than importing tobacco directly. If they import the tobacco themselves, they are required to have a permit and pay the duty when the tobacco enters the country.

Duty free stores, providores and catering bonds (entities which store goods to be supplied to international aircrafts or ships) are exempt from the change in tax point. The importers who supply these stores are able to claim a refund of the duty that was paid at the border.

Consistent with existing arrangements, where travellers are found with tobacco at the border above the duty-free threshold (25 cigarettes), they are given the option of paying the duty at the border or forfeiting the tobacco.

### 16. What is the Government doing to address the delays in refunds and drawbacks for tobacco under the new arrangements?

Since 1 July 2019, one major tobacco importer has raised with Home Affairs that it takes too long to receive a refund of duty paid under the new arrangements for tobacco that is provided to duty free stores or re-exported.

Home Affairs advises that all importers are encouraged to utilise a licensed customs broker on their behalf as a way to facilitate smoother and more efficient processing of refund and drawback claims. Home Affairs will only consider a refund or drawback claim once all relevant information has been provided.

## Background

### 17. Overview of the tobacco importing industry.

Since 1 July 2019, all tobacco imports are taxed at the border.

There were previously only 37 importers of tobacco who stored tobacco under bond in licenced warehouses (before tobacco is entered for home consumption). The largest 3 importers accounted for approximately 97 per cent of all imports.

There are approximately 1000 other small importers who previously paid at the border.

### 18. What are the different tobacco types?

There are three main types of tobacco consumed in Australia:

**Cigarettes/cigars:** Cigarettes are the most common form of tobacco consumed in Australia.

**Roll Your Own (RYO):** Loose leaf tobacco, which people roll into cigarettes using cigarette papers. It is cheaper than buying retail cigarettes.

**Molasses (shisha):** Molasses tobacco, also known as shisha tobacco, is a syrupy tobacco mix with flavours added to it. It is commonly smoked through a water pipe and can have a tobacco content of anywhere from 30 per cent to 70 per cent.

Other types of tobacco, which are not currently legal in Australia include:

**Electronic devices (E-cigarettes):** Products that heat 'e-liquids' to form an aerosol, which is then inhaled by the user. E-liquids containing nicotine are illegal and not for sale in Australia.

**Smokeless tobacco (snuff or snus):** Smokeless tobacco product placed under the lip. It is currently not legal in Australia after being outlawed in 1991.

**Chewing tobacco:** A smokeless tobacco product which is chewed. It is currently not legal in Australia.

### 19. How much revenue is raised through tobacco duty?

At the 2019-20 Budget, tobacco receipts for 2019-20 are forecast to be \$17,410 billion, reflecting the commencement of the 2018-19 Budget measure *Black Economy Package — combatting illicit tobacco*, which included the shift in the taxing point to the border. The Final Budget Outcome for tobacco receipts for 2018-19 was \$12,147m.

### 20. What are the current excise rates for tobacco?

- Tobacco in stick form not exceeding 0.8 grams (e.g. cigarettes): \$0.93653 per stick
- Other tobacco (e.g. loose leaf tobacco): \$1291.77 per kilogram

Tobacco excise rates are indexed to Average Weekly Ordinary Time Earnings. The increases occur on 1 March and 1 September each year.

Tobacco excise rates increased by 12.5 per cent on 1 September 2019 and will increase by an additional 12.5 per cent on 1 September 2020. This reflects the decision taken in the 2016-17 Budget to increase excise rates each year from 2017 to 2020.

The per kilogram rate is being adjusted over four years, from 2017 to 2020, to align the tax treatment of roll your own tobacco and cigarettes. These adjustments occur on 1 September each year.

	March 2012	Sept 2012	March 2013	Sept 2013	March 2014	Sept 2014	March 2015	Sept 2015	March 2016	Sept 2016
<b>Indexation (AWOTE)</b>		1.006	1.016	1.008	1.137	1.139	1.016	1.13	1.012	1.136
<b>Legislated</b>				12.5%*		12.5%		12.5%		12.5%
<b>Excise per kilogram(\$)</b>	433.53	436.13	443.11	446.65	508.01	578.37	587.62	663.70	671.68	763.20
<b>Excise per stick(\$)</b>	0.34681	0.34889	0.35447	0.35731	0.40639	0.46268	0.47008	0.53096	0.53733	0.61054

\*December 2013

	March 2017	Sept 2017	March 2018	Sept 2018	March 2019	Sept 2019	March 2020	Sept 2020	March 2021	Sept 2021
<b>Indexation (AWOTE)</b>	1.011	1.132	1.017	1.010	AWOTE	AWOTE	AWOTE	AWOTE	AWOTE	AWOTE
<b>Legislated</b>		12.5%		12.5%		12.5%		12.5%		
<b>Excise per kilogram(\$)</b>	771.60	901.39	916.72	1,076.35	1,090.33	1291.77				
<b>Excise per stick(\$)</b>	0.61726	0.69858	0.71046	0.80726	0.81775	0.93653				

## 21. How is the 12.5 per cent applied?

The 12.5 per cent is applied at the same time as AWOTE (1 September each year to 2020). It doesn't matter which is applied first as it's multiplicative.

## 22. What is the price of a pack of cigarettes, and how much is excise?

Product	Recommended retail price	Excise rate (per stick)	Current duty component	GST	Total tax
Example mid-range (pack of 25)	\$37.00	0.93653	\$23.41	\$3.36	\$26.77

## 23. Is the illicit tobacco market a result of higher excise rates?

According to the World Health Organisation increasing tobacco duty is among the most effective interventions to reduce the prevalence of smoking. Some criminals have chosen to break the law and not pay duty. The Government is continuing to take action to address this criminal behaviour.

The exact amount that the illicit tobacco market can be expected to grow due to an increase in excise rates cannot be accurately measured because the illicit market is driven by a multitude of factors of which the duty rate is only one.

## 24. Reasons for tobacco excise (and are our tobacco taxes too high?)

There have been significant efforts by governments in recent years to reduce tobacco consumption through a comprehensive suite of tobacco control measures, including staged increases and a swap to wage indexation for tobacco excise.

The taxation of tobacco products helps to pay for essential services such as the delivery of health services and other areas of spending that benefit the whole Australian community.

The World Health Organisation (WHO) identifies price increases through taxation as one of the most effective ways governments can reduce tobacco consumption. Australia is a signatory to the WHO Framework Convention on Tobacco Control, a treaty to address the health, social, environmental and economic consequences of tobacco consumption and exposure to tobacco smoke worldwide.

Australia's tobacco tax rates are nearing the World Health Organisation's recommended level, which recommends that duty should account for 70 per cent of the retail price of tobacco products.

Excise increases announced in the 2016-17 Budget will improve the health of Australians by reducing their exposure to tobacco products and move Australia closer to the World Health Organization's recommended level of tobacco excise.

As of 1 September 2019, tobacco duty was estimated to account for between 60 and 71 per cent of the retail price of four popular brands of manufactured cigarettes sold in Australia.

## **25. Who has jurisdiction for combatting illicit tobacco?**

The Department of Home Affairs is responsible for combatting tobacco smuggling, such as attempts to import tobacco using cargo containers or the international mail without paying customs duty.

The ATO is responsible for combatting illicit domestic tobacco crops.

The way both agencies address illicit tobacco at the retail level is by attempting to cut-off illicit tobacco at the source (domestic crops and smuggling).

State and Territory police forces provide intelligence and protection for ATO and Border Force officers conducting raids on illicit domestic tobacco crops or shipments.

Under the new Illicit Tobacco Task Force, the ATO, the Department of Home Affairs and the New South Wales and Victorian Police Forces, as well as a number of other enforcement agencies, work together as part of a single taskforce to combat tobacco smuggling.

The additional funding for the ATO provides additional investigators to detect and destroy illicit tobacco crops and conduct follow-up criminal investigation activity. These activities will continue to be conducted in partnership with local police forces.

## **26. What are the new offences in the Illicit Tobacco Offences legislation?**

The Government increased offences for illicit tobacco in August 2018.

The new offences include penalties for reasonable suspicion offences (see table below), where it is reasonable to assume that duty has not been paid on the tobacco. This makes it easier for the Illicit Tobacco Taskforce and the ATO to prosecute offenders in instances where more than 5kgs of illicit tobacco is found but it is difficult to prove intent.

A civil penalty has also been introduced for the possession of more than 2kgs of tobacco where there is a lack of documentary evidence to justify the possession of the tobacco. The penalty is a fine of up to \$21,000.

The customs amendments make it an offence to import tobacco where a person is reckless as to whether they are defrauding the revenue. The penalty will be up to 5 years imprisonment and/or a fine of 3 times the duty payable or up to \$105,000.

The law removes the requirement for prosecutors to prove whether the illicit tobacco was grown domestically or imported, which made it difficult to take enforcement action.

The penalties for each tiered offence are:

Penalties	Reasonable suspicion	Intentional offences
<b>5kg or more</b> [Considered a limited commercial use]	The greater of: • \$42,000 fine; or • 5 times duty payable	The greater of: • \$105,000 fine; or • 5 times duty payable
<b>100kg or more</b> [Considered a marketable quantity]	2 years imprisonment or greater of: • \$105,000 fine; or • 5 times duty payable	5 years imprisonment or greater of: • \$210,000 fine; or • 5 times duty payable
<b>500kg or more</b> [Considered a commercial quantity]	5 years imprisonment or greater of: • \$210,000 fine; or • 5 times duty payable	10 years imprisonment or greater of: • \$315,000 fine; or • 5 times duty payable

## 27. Why is the Government not actioning the Black Economy Taskforce recommendation regarding track-and-trace, as noted in a recent World Bank report?

The World Bank released the report ‘Confronting Illicit Tobacco Trade – A Global Review of Country Experiences’ on 23 January 2019. It recognises the significant measures announced by Government to strengthen both enforcement capabilities and tobacco tax administration following the work of the Black Economy Taskforce.

A key criticism in the World Bank report ‘Confronting Illicit Tobacco Trade – A Global Review of Country Experiences’, 23 January 2019 concerns Australia’s lack of track-and-trace. It notes:

“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...” (Treasury 2018: 35).”

It is expected that the 2017-18 and 2018-19 Budget measures will have a significant impact on the illicit tobacco market in Australia and the Government will assess the impact of these measures before determining whether Australia should adopt track and trace and become a Party to the Protocol.

Most countries do not currently use a track-and-trace approach. Two countries that have adopted track-and-trace in recent years include Brazil, which began operating a track-and-trace system in 2008, and Ecuador, which implemented track-and-trace for domestically produced cigarettes in 2017. In addition to these countries, EU member states are poised to introduce an EU-wide tracking and tracing system by May 2019.

## 28. Potential registration of tobacco license holders on a public register

The major tobacco importers have also suggested a register of permit holders be published to assist retailers in identifying suppliers of illicit tobacco.

Treasury and Home Affairs is concerned about privacy issues for tobacco permit holders who may wish not to be publicly identified.

As with track and trace, Home Affairs and Treasury consider the Government should monitor the impact of the illicit tobacco package before considering further measures.

## **29. KPMG 'Illicit Tobacco in Australia' Report 2018**

KPMG's Illicit Tobacco in Australia Report, commissioned by Philip Morris and Imperial Tobacco, estimates that illicit tobacco cost the Government \$2.02 billion in forgone revenue in 2018.

- The KPMG estimate of forgone revenue is significantly larger than the Australian Taxation Office (ATO) and Department of Home Affairs (DHA) tax gap research, which estimated illicit tobacco represented around \$600 million of forgone revenue in 2015-16. An explanation of the differences between these estimates is at Additional Information.

KPMG also found that consumption of illicit tobacco declined by 11.1 per cent between 2017 and 2018. As a proportion of all tobacco consumption, consumption of illicit tobacco fell from 15.0 per cent in 2017 to 14.1 per cent in 2018.

Contraband accounted for 53.7 per cent of illicit tobacco consumption. Contraband refers to cigarettes manufactured legally outside of Australia and smuggled into the country.

KPMG's estimates differ from the tax gap analysis prepared by the ATO and Home Affairs, in part because they measure different things and use different methodologies.

- The KPMG methodology primarily uses a consumption model based on a consumer survey; and an empty pack survey analysis. The ATO and Home Affairs methodology uses a supply side model.

Some aspects of the KPMG methodology are considered to be prone to variance including

- The use of empty packet analysis, as it is impossible to estimate and adjust for legitimate overseas imports and the duty free allowance for international air passengers.
- Surveys suffer from misinterpretation and error.
- A change in the methodology through a new panel of respondents.

The estimates by the ATO and Home Affairs are based on extensive and high quality data held by these agencies, and use a methodology endorsed by independent experts.

## **30. Why is the Government not actioning the Black Economy Taskforce recommendation to reduce taxes and duties on molasses tobacco (shisha)?**

Molasses tobacco, also known as shisha tobacco, is a syrupy tobacco mix with flavours added to it. It is commonly smoked through a water pipe and can have a tobacco content of anywhere from 30 per cent to 70 per cent.

The addition of flavours and water to the tobacco leaves makes it difficult to determine the actual tobacco content of molasses tobacco without special scientific instruments.

Reflecting this, changes were made in 2008 so that molasses tobacco was taxed on its total weight, not just its tobacco content. This made it significantly easier for Border Force personnel to determine the duty payable on the tobacco.

Reversing that change would be a significant impost on the Border Force and would divert resources from higher risk border security activities such as stopping illicit drugs and guns.

The additional resources dedicated to combating tobacco smuggling and the introduction of the new permit system will address illicit shisha tobacco imports.

s 22





**FOR OFFICIAL USE ONLY****How else is the Government combating illicit tobacco?**

In the 2016-17 Budget the Government provided an extra \$7.7 million of funding for the Tobacco Strike Team.

The tobacco strike team has seized 400 tonnes of illicit tobacco with an estimated dutiable value of around \$300 million.

**What has been done to combat illicit tobacco prior to the introduction of this legislation?**

The ATO has undertaken 16 investigations since 1 July 2016 resulting in the seizure and destruction of almost 120 tonnes of illicit tobacco, with an estimated duty forgone of over \$91 million. Since 1 July 2011 the ATO has conducted 26 investigations seized illicit tobacco with an estimated duty forgone of \$160 million.

The ATO focuses on domestic growing and production and due to constraints with the current law (the proof of origin concept) is limited to being able to seize illicit tobacco and prosecute people caught growing it.

**Are our tobacco taxes too high?**

Australia taxes tobacco below the World Health Organisation's recommended level of tobacco excise, which is that excise should account for 70 per cent of the retail price of tobacco products.

As of 1 September 2017, tobacco excise was estimated to account for between 53 and 62 per cent of the retail price of five popular brands of manufactured cigarettes sold in Australia.

As part of the 2016-17 Budget, the Government announced four annual 12.5 per cent tobacco excise increases, beginning 1 September 2017. These increases will bring Australia closer to meeting the World Health Organisation's target.

– The excise increases are in addition to the biannual indexation to average weekly ordinary time earnings.

s 22



### **Has increasing the excise rate resulted in more illicit tobacco?**

Treasury has not estimated how much revenue has been lost due to the consumption of illicit tobacco in Australia.

*Background:* The 2017 KPMG *Report into Illicit Tobacco* estimated that \$1.61 billion more in revenue would have been received in 2016 if all illicit tobacco consumption had been legal consumption. Philip Morris Ltd and Imperial Tobacco Australia Ltd commissioned the report.

### **Given government has increased the taxation of tobacco, what is the government doing to combat illicit tobacco?**

The Government has established a Black Economy Taskforce to develop a forward-looking whole-of-government strategy to combat the black economy.

- A Final Report is being considered now.

In the 2016-17 Budget, the Government announced an additional \$7.7 million in funding to expand the Tobacco Strike Team, and reforms to the *Customs Act 1901* and *Excise Act 1901* to provide enforcement officers with access to tiered offences.

- The expansion of the Tobacco Strike Team has taken place, and legislation to implement tiered offences continues to be progressed.

- Since October 2015, the Australian Border Force has stopped more than 400 tonnes of illicit tobacco (valued at \$294 million) from reaching the black market. Refer questions on the Tobacco Strike Team to DEPT OF HOME AFFAIRS.

### **Who is responsible for stopping illicit tobacco?**

The Commonwealth and the States and Territories share responsibility for illicit tobacco.

Commonwealth departments including the Australian Federal Police, Australian Border Force, the ATO, the Australian Crime Commission and the Australian Transaction Reports and Analysis Centre (AUSTRAC) work with State and Territory police to combat illicit tobacco importation and cultivation.

Treasury is responsible for setting excise taxation rates. Treasury does not engage in enforcement activities.

## FOR OFFICIAL USE ONLY

The ATO is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products. The ATO is also responsible for ensuring that businesses, such as tobacco retailers, are correctly declaring income and sales for income tax purposes and GST reporting.

- Where crops are identified the ATO takes action to disrupt those operations, however most illicit product is thought to be imported. Refer further questions on combatting domestically grown illicit tobacco to the ATO.
- *Background:* Since 2006 no-one has been licensed to grow tobacco in Australia.

Department of Home Affairs is responsible for preventing illicit tobacco from being imported into Australia and collecting customs duties and taxes on imported tobacco products.

### ***If asked about illicit tobacco in the retail environment***

The Department of Home Affairs and the ATO focus their resources on cutting off the imported and domestic supply of illicit tobacco at the source as opposed to individual retail outlets.

s 22



### **Talking points from the 2023-24 Budget changes to *Aligning the treatment of stick and non-stick tobacco tax and increasing tobacco tax***

- The Government is taking steps to reduce smoking and nicotine use and address the physical and social harms it causes.
- These changes are part of the Government's response to the National Tobacco Strategy and related initiatives on vaping and smoking prevention and cessation, and an enhanced regulatory approach to vaping.
  - The Government announced a range of health measures in the 2023-24 Budget targeted at tobacco and vape use. These include;
    - : increased funding for smoking and vaping cessation services, expanded the Tackling Indigenous Smoking Program, and established national public health campaigns to prevent uptake and reduce smoking and vaping.
    - : The Government is also providing ongoing funding to establish and maintain a new national lung cancer screening program. The program will support the early detection of lung cancer in high-risk individuals.
- The tax changes to tobacco complement the National Tobacco Strategy and involve:
  - increasing the tax on tobacco by 5 per cent per year for 3 years from 1 September 2023, in addition to the normal indexation of tobacco excise; and
  - aligning the tax treatment of loose-leaf tobacco products (such as roll-your-own tobacco) with the manufactured stick excise rate to ensure loose-leaf tobacco is taxed equally.
- The first of the 5 per cent increases to tobacco excise has taken effect from 1 September 2023.

### **Tobacco Use**

- Tobacco use remains the leading cause of preventable death and disability in Australia and was estimated to be the cause of death of over 20,000 Australians in 2018.
  - In 2021-22, 10.1 per cent of people aged 18 plus in the general population (2 million Australians) reported daily smoking.
- Statistics from the National Health Survey, last released in 2018, indicate that since 1995, the proportion of adults who are daily smokers has decreased from 23.8 per cent to 13.8 per cent in 2017-18.
- The National Tobacco Strategy 2023-2030 aims to achieve a national daily smoking prevalence of less than 10 per cent by 2025 and 5 per cent or less by 2030 in Australia, and to reduce the daily smoking rate among First Nations people to 27 per cent or less by 2030.

### **Risks and Sensitivities**

#### **Illicit tobacco risks**

- Further increases to the tobacco excise and excise-equivalent customs duty will, however, strengthen incentives to trade in illicit tobacco, both counterfeit cigarettes and loose-leaf tobacco, as well as substitution into electronic cigarettes ("vapes") containing nicotine, which are substantially cheaper than even illicit cigarettes.

### Demographic impacts

- The package of health measures in the budget will provide support on prevention, cessation and health care:
  - Some programs are targeted at socially disadvantaged groups such as the Aboriginal and Torres Strait Islander Cancer Plan and First Nations Cancer Package.
  - The Government is also providing ongoing funding to establish and maintain a new national lung cancer screening program. The program will support the early detection of lung cancer in high-risk individuals and the screening program will target older Australians with a history of heavy smoking.
- Tobacco tax changes, viewed in isolation, can disproportionately impact socially disadvantaged groups, who are more likely to be regular smokers, and suffer corresponding health impacts. These include:
  - First Nations Peoples – according to the Australian Bureau of Statistics' 2019 National Aboriginal and Torres Strait Islander Health Survey, around 41 per cent of First Nations peoples aged 15 or over were current smokers in 2018-19, which is substantially higher than the general population
  - lower socio-economic and labour force status groups
  - adults living in areas of most disadvantage
  - adults living in outer regional and remote Australia
  - persons with a highest level of educational attainment of Year 10 or below
  - people aged 50-59; and
  - people with mental health conditions and high psychological distress.
- However, socially disadvantaged groups are also those that are more likely to quit smoking in response to increases in prices.

## Question and Answers

### **How do these changes tie in with the National Tobacco Strategy 2023-2030 and the excise changes announced in the 2023-24 Budget?**

Australian Government policy has long reflected that tobacco smoking in all its forms is dangerous. The National Tobacco Strategy outlines a national policy framework for government and non-government organisations to work together to improve the health of all Australians by reducing smoking rates.

The annual 5 per cent increase to the tax on tobacco supports the National Tobacco Strategy priority of strengthening regulation to reduce the supply, availability, and accessibility of tobacco products.

The better alignment of the tax treatment of loose-leaf tobacco products with the manufactured stick excise and excise equivalent customs duty will help to ensure these products are taxed equally.

### **What is the Government doing to reduce smoking and vaping**

The Albanese Government is taking strong action to reduce smoking and stamp out vaping – particularly among young Australians – through stronger legislation, enforcement, education and support.

The 2023–24 Budget includes \$737 million to fund a number of measures to protect Australians against the harm caused by tobacco and vaping products.

These measures complement the development of new proposed national tobacco control legislation first announced by the Government in November 2022.

**Tobacco taxes & illicit tobacco – Additional Points**

s 22

**2. Does Treasury think high tobacco taxes are driving illicit tobacco in Australia?**

- The illicit market is driven by a multitude of factors, of which the excise rate is only one.
- Tobacco use remains the leading cause of preventable death and disability in Australia.
  - Reducing the affordability of tobacco products through taxation increases remains the most effective measure in reducing smoking rates.
- The decision to take further action on illicit tobacco is a matter for government.

**3. Does Treasury think tobacco taxes are now too high?**

- Tobacco use remains the leading cause of preventable death and disability in Australia.
- Reducing the affordability of tobacco products through taxation increases remains the most effective measure in reducing smoking rates.
- The increasing tobacco excise has a very clear basis — the best deterrent for consumer demand is price.
  - The World Health Organisation (WHO) recognises this as the most effective intervention that governments can make. As such, tobacco taxation remains a central component of Australia's tobacco control response.

# TAD

## Chart of the Week

s 22

For the first time, the latest [Intergenerational Report](#) (IGR) modelled a decline in indirect taxes over the coming 40 years, driven partly by declines in tobacco excise (see IGR Box 8.1). As tobacco excise is one of the largest sources of indirect tax, declines in smoking rates have implications for the sustainability of the tax base. This week's chart highlights the uncertainty of the outlook for tobacco excise receipts over the IGR period.

s 22

The IGR baseline modelling of tobacco (blue line) assumes that the quantity of tobacco products imported, or clearances, will remain constant over the long run. This is consistent with the approach taken for the medium-term tobacco projections and represents a decline in per capita consumption of legal tobacco as the population grows. Tobacco collections are projected to decline from 0.5 per cent of GDP in 2022-23 to less than 0.4 per cent of GDP in 2062-63 in this baseline. However, this somewhat simplified assumption does not factor in the impact of future policy change (which has likely had a significant impact on smoking rates in the past), future changes in preferences, the rise of vaping, or the growing illicit market – all of which are very difficult to project.

To demonstrate the potential revenue impact of a faster decline in tobacco consumption, we examined the National Health Survey data collected by the Australian Bureau of Statistics on changes in numbers of daily smokers by age and sex from 2011-12 to 2020-21. We compared corresponding cohorts (e.g., 25-34 year old males in 2011-12 with 35-44 year old males in 2020-21), and found significant falls in smoking rates for all cohorts. Assuming rates of smoking would continue to decline at the same rate over the IGR projection period, excise receipts would decline to less than 0.1 per cent of GDP by the end of the IGR period (red line).

s 22



## BACKPOCKET – Tobacco excise receipts, clearances, and forecasts

### Senate Estimates briefing – October 2024

#### Key Points

##### Policy context

- The Government is committed to reduce smoking related harms in Australia:
  - Tobacco use remains the leading cause of preventable death and disability in Australia.
  - Reducing the affordability of tobacco products through taxation increases remains the most effective measure in reducing smoking rates.
- As part of the 2023-24 Budget, the Government announced further increases to tobacco excise (and excise-equivalent customs duty) of 5 per cent a year for 3 years, from 1 September 2023 to 1 September 2025.
  - The Government is also progressively lowering the equalisation weight for loose-leaf tobacco from 0.7 grams to 0.6 grams per stick in annual increments from 1 September 2024 to 1 September 2026.

s 22



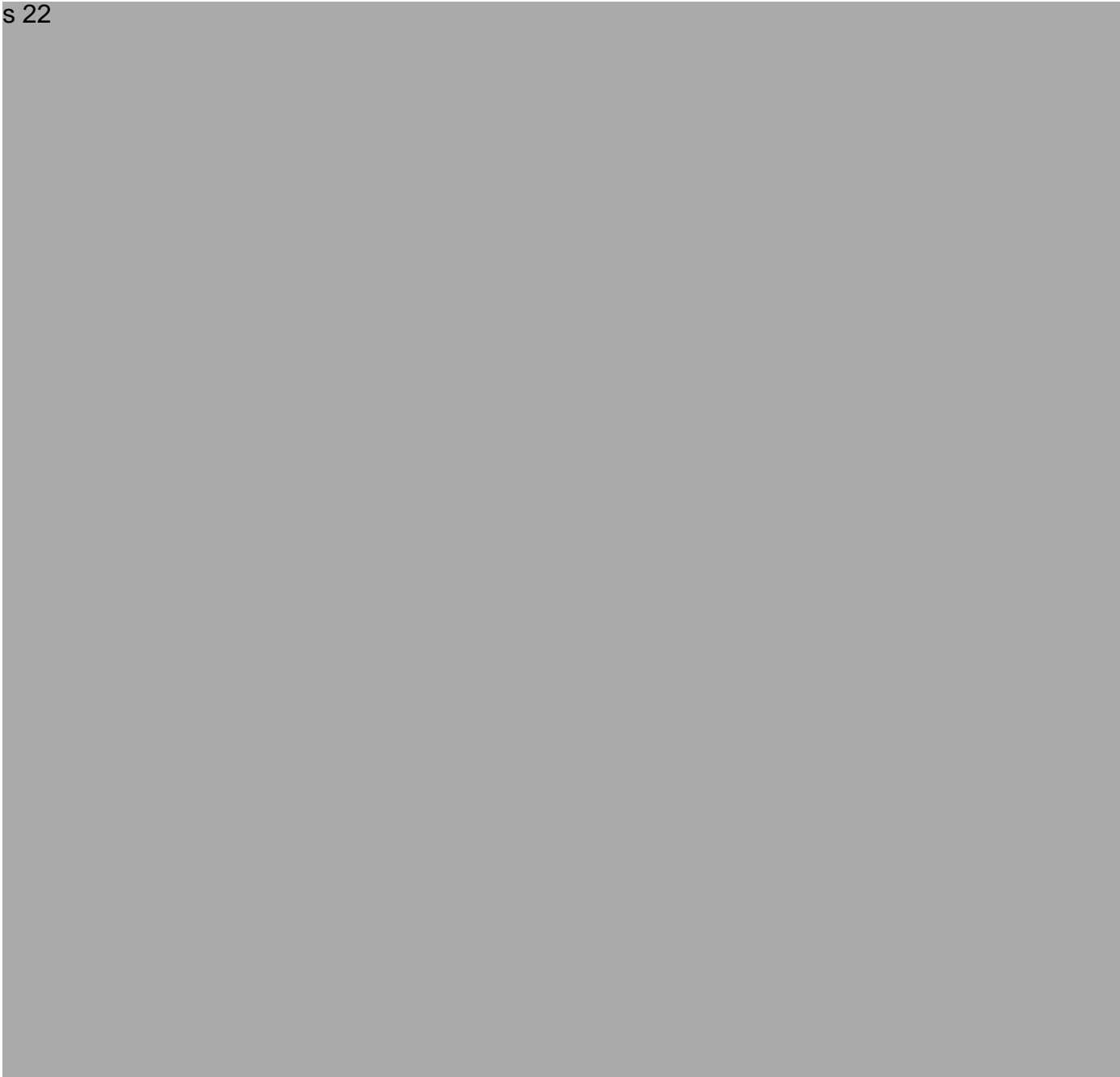
- The increasing tobacco excise has a very clear basis — the best deterrent for consumer demand is price.
  - The World Health Organisation (WHO) recognises this as the most effective intervention that governments can make. As such, tobacco taxation remains a central component of Australia’s tobacco control response.

s 22



- The illicit market is driven by a multitude of factors of which the excise rate is only one.

s 22



- While clearances have been in a long-term decline, the steep decline in 2023-24 is being driven by a combination of factors, including:
  - increased substitution to the illicit market, which is partly driven by higher excise rates,
  - higher rates of quitting, and
  - weaker growth in discretionary spending due to cost-of-living pressures also affecting tobacco consumption.

s 22



s 22

### Impact of the 2023-24 Budget measure on tobacco receipts

- In the 2023-24 Budget, the Government increased tobacco excise by 5 per cent per year for three years from 1 September 2023, in addition to normal indexation. The Government also aligned the tax treatment of tobacco products subject to the per kilogram excise rate with the per-stick rate, by progressively lowering the 'equalisation weight' from 0.7 to 0.6 grams over four years, starting on 1 September 2023 and reaching 0.6 grams on 1 September 2026.

s 22

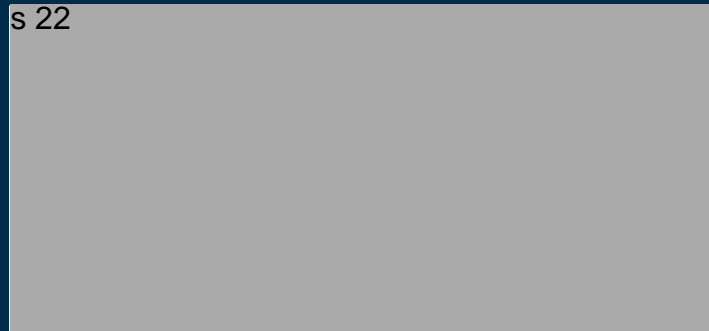
- It is not possible to split out the impact of the 2023-24 Budget measure on the decline in tobacco tax receipts, but the drivers would include:
  - Increased substitution to the illicit market
  - Higher rates of quitting
  - Continued weaker growth in discretionary spending due to cost-of-living pressures also affecting tobacco consumption

s 22



# Elasticity analysis for tobacco

s 22



# What is the price elasticity of tobacco?

- The price elasticity of tobacco demand measures the response of quantity of tobacco consumed to tobacco price change.

$$\varepsilon = \frac{\partial x/x}{\partial p/p}$$

- the percentage change in consumption of tobacco for one percentage change in tobacco price.

# Why we estimate and update the elasticity?

- Inclusion of the elasticity in the tobacco costing model captures behaviour response to rate changes.
- It improves calculation of financial implications of policy proposals.

# Elasticity estimation

- The price elasticity used in the current tobacco costing model
  - Least squared analysis in excel (1995-2015)
    - $\ln v_t = \alpha + \beta \ln p_t + \varepsilon_t$ , (1)
    - $v_t$ : volume of tobacco consumed
    - $p_t$ : relative price (tobacco price/household consumable goods price)
    - $\beta$ : price elasticity
  - $\beta = -0.5$
- Two improvements in this update:
  - Model: add income and habits/addiction to the model
  - Data: update the dataset



# A dynamic demand model for tobacco in Australia

- Desired tobacco consumption

$$v_t^* = \kappa_1 p_t^{\kappa_2} y_t^{\kappa_3}, \quad (2)$$

- Actual tobacco consumption

$$v_t = (v_t^*)^\theta (v_{t-1})^{1-\theta}, \quad (3)$$

$$\begin{cases} \theta = 1, v_t = v_t^* \text{ (full adjustment)} \\ \theta = 0, v_t = v_{t-1} \text{ (zero adjustment)} \end{cases}$$

# Model specification

- Combining (2) and (3) and taking logarithms, the empirical model to estimate is

$$\ln(v_t) = \beta_0 + \beta_p \ln(p_t) + \beta_y \ln(y_t) + \beta_v \ln(v_{t-1}) + \varepsilon_t, \quad (4)$$

- $y_t$ : household disposable income/CPI
- $v_{t-1}$ : tobacco consumption at year t-1
- $\beta_0 = \theta \ln(k_1)$ ;  $\beta_p = k_2 \theta$ ;  $\beta_y = k_3 \theta$ ;  $\beta_v = 1 - \theta$

# Discussion

- The point estimate of tobacco price elasticity is around -0.4, consistent with expectation and the World Bank estimate of the developed world average.
- Costing using the updated elasticity for a hypothetical 12.5% increase in rate for 2021-22:

s 22



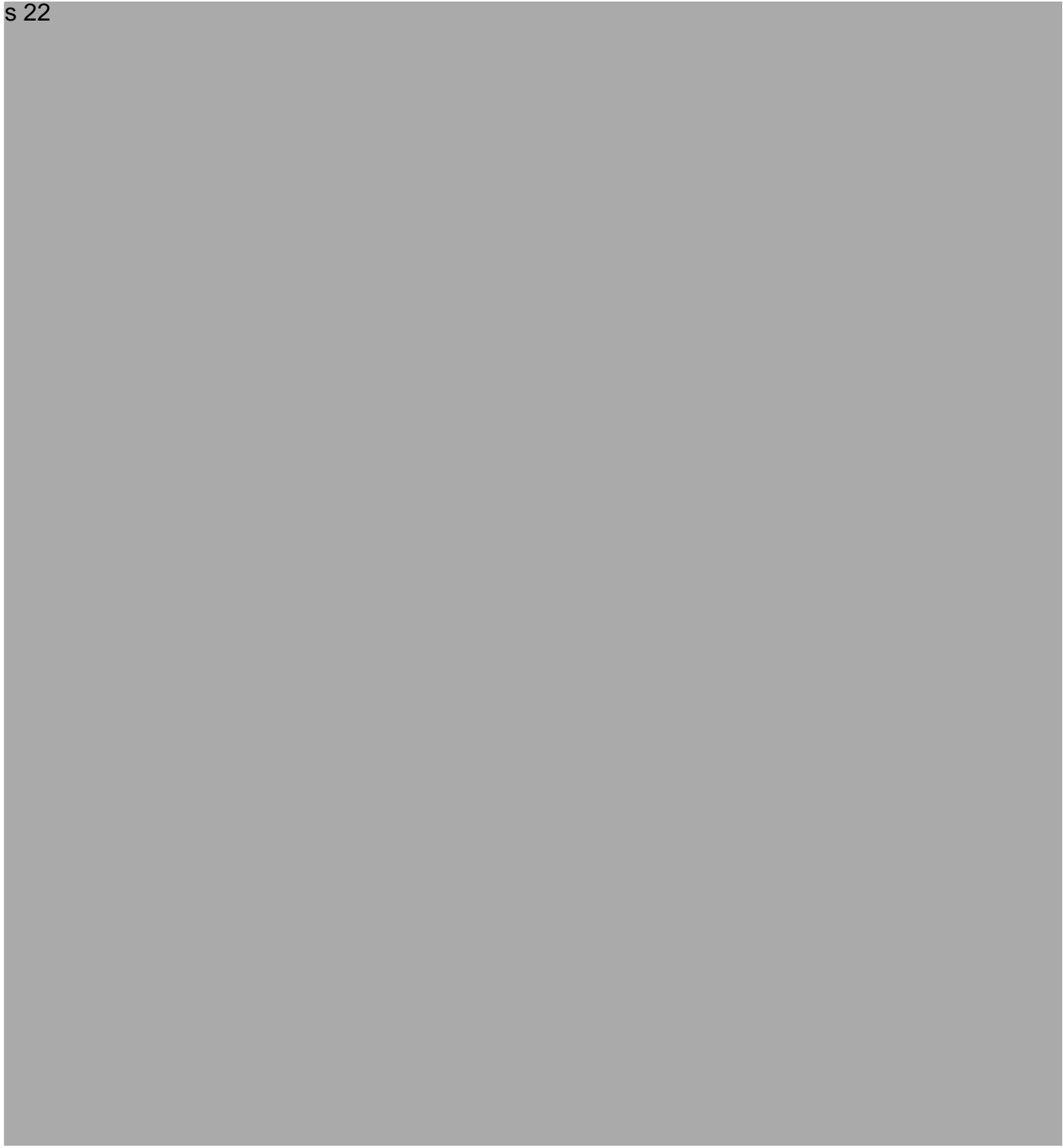


Australian Government  
The Treasury



## Internal Brief: Preliminary 2024-25 MYEFO outlook for tobacco excise receipts

s 22



- These downgrades reflect the following factors:
  - Preliminary tobacco receipts to end-October are lower than the 2023-24 financial year by \$0.5 billion s 22
  - Increased substitution to the illicit market, which is partly driven by higher excise rates,
  - increased substitution to vaping,
  - higher rates of quitting, and
  - the effect of weaker growth in discretionary spending due to cost-of-living pressures on tobacco consumption.

s 22



## Additional information

### Illicit tobacco

- A contributing factor to the decline in legal tobacco consumption is the large difference in price between legal and illicit products.
  - Illicit tobacco products are sold at a considerably lower price compared to legal tobacco (around \$15 cheaper for a standard 20s cigarette pack).

s 22



s 22



Smoking, vaping, and tobacco excise

**Senate estimates briefing points – June 2024**

s 22



### The 23-24 Budget measure and tobacco excise receipts

- It is not possible to split out the impact of the 2023-24 Budget measure on the decline in tobacco tax receipts, but the drivers could include:
  - Increased substitution to the illicit market
  - Continued weaker growth in discretionary spending due to cost-of-living pressures also affecting tobacco consumption
  - Higher rates of quitting



**Senate Economics Legislation Committee**  
**ANSWERS TO QUESTIONS ON NOTICE**  
**Treasury Portfolio**  
Budget Estimates 2023 - 2024

**Agency:** Department of the Treasury  
**Question No:** BET098  
**Topic:** Vapour Revenue Modelling  
**Reference:** Written (13 June 2023)  
**Senator:** Hollie Hughes

**Question:**

1. In the lead up to the Budget, it was publicly reported the Treasury was hinting that vaping may soon be subject to tougher taxes and that the Albanese Government is considering all options to the issue. Has Treasury ever modelled the potential revenue from taxing vaping products like we do with alcohol or tobacco?

If No:

2. If Treasury has never modelled potential revenue from regulating vaping products like tobacco or alcohol, the Australian Government never really did have all options on the table to fix this crisis.

<https://www.news.com.au/national/nsw-act/politics/treasurer-jim-chalmers-slams-vaping-explosion/news-story/507143527e513d1f552688ab4ec305eb>

3. I refer to Table 5.7 general government receipts in on Page 185 of Budget Paper 1. In relation to the projected \$55.2 billion of tobacco excise revenue over forwards – what impact or assumptions with regards to Australia’s vaping rate have been factored into this calculation?

4. The Federal Health Minister has publicly stated – and I quote – “young people who vape are three times as likely to take up smoking” – as part of the modelling undertaken by Treasury, is the Australian Government banking on more youth smoking to underpin tobacco excise?

5. (If no or it hasn’t been taken into account) – So to confirm, while the Health Minister states those vaping are three times more likely to smoke this assumption hasn’t been included within the modelling projections – is this because the Health Minister’s statement is not reliable or statistically significant?

[https://budget.gov.au/content/bp1/download/bp1\\_2023-24.pdf](https://budget.gov.au/content/bp1/download/bp1_2023-24.pdf)

<https://www.health.gov.au/ministers/the-hon-mark-butler-mp/media/taking-action-on-smoking-and-vaping?language=en>

6. With reference to tobacco excise government receipts – after the recent vaping crackdown announcement from the Australian Government Professor Ron Borland the Deputy Director of the Melbourne Centre for Behaviour Change at the University of Melbourne publicly stated – and I quote – “I think there is a high likelihood it will result in an increase in the rates of tobacco smoking, even though it will achieve its proximal goal of reducing levels of vaping in the community.”

7. Has this 'high likelihood' of increased rates of smoking been factored into the forward estimates for excise revenue?
8. Has nothing been factored into the tobacco excise modelling because Treasury doesn't have confidence the announced vaping crackdown will work?
9. Does Treasury view there is a substitution factor between tobacco products and nicotine vaping products?
10. (If there is a substitution factor or increased smoking has been factored in) – To confirm, a key beneficiary of the Australian Government's recently announced vaping policy will be Treasury through increased tobacco excise receipts?

**Answer:**

1. Treasury provided a range of advice and analysis to support the development of various health initiatives in the Budget.
2. Please refer to response for question 1.
3. Tobacco excise is modelled using a 'base-plus-growth' approach, where the latest known outcomes are forecast to grow according to economic parameters. While we don't explicitly estimate the impact of vaping, the effects of vaping on tobacco excise are accounted for in the baseline and historical data.

For more information see Treasury Working Paper 2019-03, *Tobacco excise: historical trends and forecasting methodology*

[https://treasury.gov.au/sites/default/files/2019-07/t392185\\_tp\\_tobacco\\_forecasting\\_working\\_paper.pdf](https://treasury.gov.au/sites/default/files/2019-07/t392185_tp_tobacco_forecasting_working_paper.pdf).

4. Please refer to response for question 3.
5. Confirmation of the modelling methodology is supplied in response to question 3.
6. N/A
7. See responses to question 3 and question 9.
8. Treasury takes all government policy into account when forecasting revenue.
9. Any substitution impacts are currently implicitly accounted for in the 'base-plus-growth' modelling approach (see response to question 3). Treasury regularly examines the data and evidence available to support its revenue forecast.
10. Please see earlier responses. Substitution between vaping and smoking is not explicitly accounted for when modelling tobacco excise, however, the effects of vaping on tobacco excise are accounted for in the baseline and historical data. Tobacco excise is collected by the Department of Home Affairs and not Treasury.