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Paper prepared by: Hon Meka Whaitiri, Minister of Customs
Date considered by Cabinet: 12 May 2022
Name of paper: Customs and Excise (Tobacco Products) Amendment Bill: Approval for Introduction
Cabinet Reference: LEG-22-MIN-0069
Purpose of the paper: To get Cabinet approval to introduce a Bill to ensure correct excise and excise-equivalent duty is able to be applied to certain tobacco goods to help reduce revenue evasion.

Some parts of this paper have been redacted *under section 9(2)(h) of the Official Information Act 1982*.



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Cabinet Legislation Committee

Minute of Decision

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Customs and Excise (Tobacco Products) Amendment Bill

Portfolio **Customs**

On 12 May 2022, the Cabinet Legislation Committee:

- 1 **noted** that the Customs and Excise (Tobacco Products) Amendment Bill (the Bill) holds a category two priority on the 2022 Legislation Programme (must be passed in 2022);
- 2 **noted** that the purpose of the Bill is to ensure the correct excise and excise-equivalent duty is able to be applied to certain tobacco goods and to reduce revenue evasion;
- 3 **noted** that the Bill achieves this by:
 - 3.1 amending the Excise and Excise-equivalent Duties Table to change the method of calculating excise and excise-equivalent duty on water pipe tobacco from per kilo of tobacco content, to total weight of the water pipe tobacco, including anything added to the tobacco during manufacturing or processing;
 - 3.2 amending the excise and excise-equivalent duty rate for water pipe tobacco to \$234.77 per kilogram, based on the current tobacco excise rate and an assumed tobacco content of 15 percent, and reflecting this rate in the Excise and Excise-equivalent Duties Table;
 - 3.3 amending section 95A of Customs and Excise Act 2018 (the Act) to prohibit the importation of water pipe tobacco and bringing such goods within scope of the permitting regime in Schedule 3A of the Act;
 - 3.4 note other provisions of the Act will apply based on engaging section 95A;
 - 3.5 including new tariff heading 24.04 in the definition of “tobacco products” in clause 21(6)(b) of Schedule 3 to the Act;
- 4 **agreed** to include new excise heading 99.67 in the definition of “tobacco products” in clause 21(6)(a) of Schedule 3 of the Act;
- 5 **s9(2)(h)** [REDACTED]
- 6 **approved** the Customs and Excise (Tobacco Products) Amendment Bill [PCO 24499/4.0] for introduction, subject to the final approval of the government caucus and sufficient support in the House of Representatives;

- 7 **agreed** that the Bill be introduced on 19 May 2022;
- 8 **proposed** that the Bill be passed through all parliamentary stages under urgency on Budget Night 2022 and commence on the day after the date of Royal assent.

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Rebecca Davies
Committee Secretary

Present:

Hon Andrew Little (Chair)
Hon Kris Faafoi
Hon Michael Wood
Hon Kiri Allan
Hon Meka Whaitiri

Officials present from:

Office of the Prime Minister
Officials Committee for LEG

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Office of the Minister of Customs

Cabinet Legislation Committee

Customs and Excise (Tobacco Products) Amendment Bill: Approval for Introduction

Proposal

- 1 I propose that the Customs and Excise (Tobacco Products) Amendment Bill be approved for introduction to the House. I intend that the Bill be passed through all of its Parliamentary stages under urgency on Budget Night 2022 (19 May 2022).

Policy

Adding water pipe tobacco to the tobacco permit regime in Schedule 3A of the Customs and Excise Act 2018

- 2 “Flavoured tobacco” is a term used to describe water pipe tobacco¹. Such tobacco is intended for smoking using a water pipe and consists of a mixture of tobacco and glycerol. This type of tobacco can contain aromatic oils and extracts, molasses and sugar, and can be flavoured with fruit.
- 3 Importers of water pipe tobacco self-declare the kilo of tobacco content (KTC) when it is entered for import to determine the amount of duty² to be paid. It is not technically possible for the New Zealand Customs Service (Customs) to accurately verify the tobacco content of the goods as there is neither a recognised method of doing this nor a domestic or international testing facility that can be used. This means it is unlikely that the correct duties are being paid on some imports of water pipe tobacco.
- 4 Customs suspect’s self-declaration by some importers is leading to material under-declaration of tobacco content and investigations have indicated that criminal entities have exploited this issue to evade paying duty.
- 5 To address this, Cabinet has agreed to make flavoured tobacco a class of tobacco prohibited from import by section 95A (1) of the Customs and Excise Act 2018 (the Act) [CAB-22-MIN-0105, 4 April 2022]. This will mean those wanting to import water pipe tobacco will require a permit to be issued by Customs in accordance with Schedule 3A prior to importation.

¹ It is also known as, water pipe tobacco, hookah, shisha, molasses and fruit tobacco. This paper uses the term water pipe tobacco as defined in the New Zealand Tariff.

² Duty includes excise-equivalent duty, tariff duty and GST.

~~BUDGET SENSITIVE~~

- 6 When forfeited goods or goods suspected to be forfeited goods are seized under section 178 of the Act, sections 185A (Condemnation of seized goods that are tobacco or tobacco products), 185B (Notice of seizure and condemnation of goods that are tobacco or tobacco products) and section 189A (Application for compensation for incorrect disposal of tobacco and certain tobacco products) and Schedule 3B of the Act apply.

Changing the applicable statistical unit from KTC to total weight and the creation of new excise and excise-equivalent duty rates for water pipe tobacco

- 7 Importers of water pipe tobacco are required to include both the gross weight of the whole shipment of the goods, and the tobacco content (net weight), on the import entry. Generally the KTC amount is not specified on the goods packaging or import documents, and has to be calculated by Customs brokers based on the net weight of the product and the percentage of the tobacco content declared by the importer.
- 8 To counter the problem of determining the actual content of water pipe tobacco for the correct levying of excise tax, Cabinet agreed to amend the method of calculating excise and excise-equivalent duty³ from per kilo of tobacco content (KTC) to total weight of the water pipe tobacco including anything added to the tobacco during manufacturing or processing [CAB-22-MIN-0105, 4 April 2022 and DEV-22-MIN-0058, 30 March 2022].
- 9 Cabinet agreed that the excise and excise-equivalent duty rate for flavoured tobacco will change, along with the change to the statistical unit used, to \$234.77 per kilogram, based on the current tobacco excise rate and an assumed tobacco content of 15 percent [CAB-22-MIN-0105, 4 April 2022 and DEV-22-MIN-0058, 30 March 2022].
- 10 Customs will make the consequential change to Part 1 of the New Zealand Tariff to align the relevant tariff codes with the changes made to the Excise and Excise-equivalent Duties Table.

Implementation

- 11 Some importers and smokers of water pipe tobacco could be concerned by the changes, as paying what is likely to be the more correct excise-equivalent duty will increase the retail price. However, any adverse impacts on users in terms of increased price would be balanced by the positive health benefits from discouraging consumption of a harmful product.

- 12 s9(2)(h) 

³ Excise is a duty (tax) imposed on domestically manufactured tobacco products. When these goods are imported, duty equivalent to the excise liability that would apply as if they were manufactured in New Zealand, is imposed (excise-equivalent duty).

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Transitional arrangements will be required

- 14 Given the intention is for these amendments to be introduced and passed on Budget Night, it is probable that there will be water pipe tobacco that is en route to New Zealand, or has been ordered pending delivery (with such delivery potentially being held-up because of global supply chain disruptions).
- 15 I propose specific transitional arrangements that deal with water pipe tobacco that the importer can demonstrate was en route, before the Bill receives Royal assent. The Bill makes it clear that water pipe tobacco will become a prohibited import and the new duty rate commences on the day after the date of Royal assent.
- 16 The Bill provides for consignments that the importer can provide evidence to show the goods were en route to New Zealand prior to the commencement date, to enter without import controls and at the pre-amendment rate of duty.

Definition of “tobacco products”

- 17 The New Zealand Tariff is based on the Harmonized Commodity Description and Coding System (HS Code), an international system that codifies all goods. The HS Code is used by over 200 countries (including New Zealand) as a basis for tariff charging and for collecting international trade statistics. The World Customs Organization (WCO) manages the HS Code.
- 18 The WCO updates the HS Code periodically to reflect changes in technology and trade patterns. Every country that uses the HS Code must implement the updated version in their national tariff. Amendments were made to the New Zealand Tariff and the Excise and Excise-equivalent Duties Table (the EEDT) to implement the latest HS Code revision, with changes coming into force on 1 January 2022.
- 19 The HS Code revision required the reclassification of some tobacco products that had previously been classified under tariff headings 24.02 and 24.03, under new tariff heading 24.04. Tobacco products reclassified under new tariff heading 24.04 retained the same excise rate that applied under the previous tariff heading. Both the New Zealand Tariff and the EEDT were amended to add new tariff heading 24.04.
- 20 There is a consequential issue that has arisen by the creation of the new tariff heading 24.04. Clause 21(6) of Schedule 3 to the Act defines “tobacco products” for the purposes of the annual inflation adjustment by reference to tariff headings 24.02 and 24.03 only. This means tobacco products classified

under the new tariff heading 24.04 are unable to be adjusted annually for inflation and will become out of step with the excise rates for tobacco products under the other two headings. The next annual inflation adjustment is scheduled for 1 January 2023.

- 21 Cabinet agreed to an amendment to include tariff heading 24.04 in the definition of “tobacco products” in clause 21(6) of Schedule 3 of the Act to enable annual inflation adjustment [CAB-21-MIN-0388, 27 September 2021 and DEV-21-MIN-0184, 22 September 2021]. The Bill achieves this by adding tariff heading 24.04 to 21(6)(b) to Schedule 3 of the Act.
- 22 The Bill amends the definition of “tobacco products” in clause 21(6)(a) of Schedule 3 of the Act by adding excise heading 99.67. This change was not covered by the Cabinet approvals referred to in paragraph 18 but is required to ensure consistency in the rates of excise and excise-equivalent duty on tobacco products covered by excise heading 99.67 and tariff heading 24.04. Excise heading 99.67 is the excise heading in Part A of the EEDT⁴ for the goods covered by tariff heading 24.04 which is in Part B⁵ of the EEDT.
- 23 Under the General Agreement on Tariffs and Trade (GATT), New Zealand cannot impose higher rates of duty on imported goods (excise-equivalent duty) than is in place on domestically manufactured goods (excise duty). Therefore, if excise heading 99.67 is not included within the definition of “tobacco products” in clause 21(6)(a) of Schedule 3 of the Act, an inflation adjustment would not be able to be made to goods in tariff heading 24.04.

Impact analysis

- 24 A regulatory impact assessment was prepared in accordance with the necessary requirements, and was submitted at the time that Cabinet committee approval of the policy relating to the Bill was sought in relation to “Amending how excise and excise-equivalent duty is calculated, and making flavoured tobacco a prohibited import to stop tax evasion” [CAB-22-MIN-0105, 4 April 2022 and DEV-22-MIN-0058, 30 March 2022].
- 25 A regulatory impact assessment was not required for the policy in relation to changes to the definition of “tobacco product” which is required as a result of the “Technical update to the New Zealand Tariff to meet our international obligations to the World Customs Organization” [CAB-21-MIN-0388, 27 September 2021 and DEV-21-MIN-0184, 22 September 2021]. Treasury's Regulatory Impact Analysis team has determined that the proposal is exempt from the requirement to provide a Regulatory Impact Statement on the grounds that it is the minimum necessary to comply with international obligations that are binding on New Zealand.

⁴ Part A goods are Goods Manufactured in New Zealand subject to excise duty.

⁵ Part B goods are the same goods which when imported are subject to excise-equivalent duty.

Compliance

- 26 The Customs and Excise (Tobacco Products) Amendment Bill complies with each of the following:
- 26.1 the principles of the Treaty of Waitangi;
 - 26.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. The seizure regime contained in the Customs and Excise Act 2018 is a traditional feature of Customs' enforcement framework. The seizure regime is far-reaching and enables goods to be seized and condemned to the Crown without the need for a prosecution and conviction. While the regime is relatively severe, for New Zealand Bill of Rights Act 1990 (NZBORA) purposes it is regarded as justified. The seizure regime was amended in 2020, providing an expedited condemnation mechanism in section 185A of the Customs and Excise Act 2018 for tobacco products. Including water pipe tobacco within the definition of tobacco products will mean it is subject to the condemnation process provided for in section 185 of the Act. The changes contained in the Bill are relatively minor and are not inconsistent with the prohibition on unreasonable search and seizure in section 21 of NZBORA because:
 - 26.2.1 the changes are procedural – the goods are already going to be forfeit and liable to seizure; it is just the subsequent steps that change;
 - 26.2.2 the range of goods affected by the change is narrow, are of low intrinsic value and are generally being imported under-declared to evade tax;
 - 26.2.3 the only significant thing that a person is deprived of is the right to seek restoration of the goods – they may still obtain compensation for the loss of the goods.
 - 26.3 the disclosure statement requirement - a disclosure statement is attached to this paper;
 - 26.4 the principles and guidelines set out in the Privacy Act 2020;
 - 26.5 relevant international standards and obligations;
 - 26.6 the Legislation Guidelines (2018 edition), which are maintained by the Legislation Design and Advisory Committee.

Consultation

- 27 The following departments have been consulted: the Treasury, Ministry of Health, Inland Revenue, Ministry of Business, Innovation and Employment, Ministry of Justice, Ministry of Foreign Affairs and Trade, Ministry for Ethnic Communities and the Parliamentary Counsel Office. The Department of the Prime Minister and Cabinet was informed.
- 28 Importers of water pipe tobacco have not been consulted due to the risk of further exploitation of weaknesses. If notice was given of these proposed changes, it is likely importers will order and stockpile product ahead of any signalled changes in order to pay less excise-equivalent duty, as the product has a two year lifespan. I consider this limited consultation is appropriate in the circumstances.
- 29 No consultation was undertaken on the technical amendment to the definition of “tobacco product” in Schedule 3 of the Act.
- 30 The Government caucus and other parties represented in Parliament have been consulted.

Binding on the Crown

- 31 The Bill will be binding on the Crown [DEV-22-MIN-0058].

Creating new agencies or amending law relating to existing agencies.

- 32 The Bill does not create a new agency.

Allocation of decision making powers

- 33 The Bill will not affect the allocation of decision making powers between the executive, the courts, and tribunals.

Associated regulations

- 34 No regulations are required to bring the Bill into operation.

Other instruments

- 35 The Bill amends the Excise and Excise-equivalent Duties Table.

Definition of Minister/department

- 36 The Bill does not contain a definition of Minister, department (or equivalent government agency), or chief executive of a department (or equivalent position).

Commencement of legislation

- 37 The Bill will come into force on the day after the date of Royal assent.

Parliamentary stages

- 38 I intend that the Bill be introduced and passed through all of its Parliamentary stages under urgency on Budget Night 2022 (19 May 2022). This is justified to prevent any further increase in under-valuation of water pipe tobacco to evade tax and enable the annual inflation adjustment to apply to goods classified in new tariff heading 24.04.

Proactive Release

- 39 I propose to release this paper after Budget 2022 decisions have been finalised, as part of the wider post-Budget proactive release of Budget papers.

Recommendations

The Minister of Customs recommends that the Committee:

- 1 **note** that the Customs and Excise (Tobacco Products) Amendment Bill holds a category 2 priority on the 2022 Legislation Programme;
- 2 **note** that the purpose of the Bill is to ensure the correct excise and excise-equivalent duty is able to be applied to certain tobacco goods and to reduce revenue evasion;
- 3 **note** the Bill achieves this by:
 - 3.1 amending the Excise and Excise-equivalent Duties Table to change the method of calculating excise and excise-equivalent duty on water pipe tobacco from per kilo of tobacco content, to total weight of the water pipe tobacco, including anything added to the tobacco during manufacturing or processing;
 - 3.2 amending the excise and excise-equivalent duty rate for water pipe tobacco to \$234.77 per kilogram, based on the current tobacco excise rate and an assumed tobacco content of 15 percent and reflecting this rate in the the Excise and Excise-equivalent Duties Table;
 - 3.3 amending section 95A of the Act to prohibit the importation of water pipe tobacco and bringing such goods within scope of the permitting regime in Schedule 3A of the Act;
 - 3.4 note other provisions of the Customs and Excise Act 2018 will apply based on engaging section 95A;
 - 3.5 including new tariff heading 24.04 in the definition of “tobacco products” in clause 21(6)(b) of Schedule 3 to the Customs and Excise Act 2018;
- 4 **agree** to include new excise heading 99.67 in the definition of “tobacco products” in clause 21(6)(a) of Schedule 3 of the Act;

- 5 ~~s9(2)(h)~~
- 6 **approve** the Customs and Excise (Tobacco Products) Amendment Bill for introduction, subject to the final approval of the Government caucus and sufficient support in the House of Representatives;
- 7 **agree** that the Bill be introduced on 19 May 2022;
- 8 **propose** that the Bill be passed through all parliamentary stages under urgency on Budget Night 2022 and commence on the day after the date of Royal assent.

Authorised for lodgement

Hon Meka Whaitiri
Minister of Customs

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