

Budget sensitive

Impact Summary: Imposing import controls over tobacco products and tobacco leaf and refuse

Section 1: General information

Purpose
<p>The New Zealand Customs Service (Customs) is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced to inform decisions to be taken by Cabinet on the regulation of tobacco products and tobacco leaf and refuse imported into New Zealand.</p> <p>This RIS provides an analysis of options for strengthening the controls on tobacco products at the border. The options are aimed at:</p> <ul style="list-style-type: none">• addressing revenue evasion (excise-equivalent duty and Goods and Services tax) from the smuggling of tobacco products, while not unduly restricting legitimate tobacco imports• disrupting the illicit market in New Zealand for tobacco products• ensuring Customs has accurate data about the volume of tobacco imports in order for New Zealand to comply with its World Health Organisation obligations. Data supplied by Customs enables the Ministry of Health to make returns on the number of cigarettes that are available for retail sale. <p>The impacts are primarily on the approximately 34 compliant commercial tobacco importers and those who are deliberately avoiding the excise regime by trading in illicit tobacco.</p>

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Key Limitations or Constraints on Analysis

The following are constraints on the analysis:

- Given the issue is aimed at illicit tobacco imports and unlicensed manufacturing, there are some constraints on quantifying the evidence of the problem. With any illicit market, it is difficult to measure the extent of the activity. About 13.8% of the adult population smokes. It is not known with any certainty what proportion of smokers access tobacco from the illicit market or the proportion of total tobacco consumed that is illicit. The annual industry funded estimate produced by KPMG estimated that illicit tobacco consumption increased from 9.2% to 10.2% of total consumption between 2017 and 2018. There are reasons to believe that the methodology used gives an over-estimate.
- Given the problems are evidence of an increase in unlawful activity, the range of options to address them are limited to strengthened regulatory controls at the border. These controls are necessary to enable Customs to meet its legislative obligations at the border in relation to tobacco products.
- It has only been possible to consult with the major importers of tobacco products due to the urgent need to prevent exploitation of gaps in border controls by smugglers. To publicise the:
 - tobacco leaf 'loophole', would likely encourage others to import the leaf and illegally manufacture it, to avoid the payment of excise
 - difficulty of controlling illegal tobacco imports through the International Mail Centre, would place more pressure on already overstretched processes.

Responsible Manager (signature and date):

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Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Status quo

The New Zealand Customs Service (Customs) is responsible for collecting excise taxes on tobacco products. For this regulatory impact assessment, tobacco products is defined to include cigarettes, pipe, and hand rolling tobacco. It is not proposed to include cigars and similar products at this stage. Smuggling of cigars is rare, and there is not sufficient cause to place further import controls on a high value product like cigars. It is forecast that Customs will collect \$430 million in excise tax from the two domestic manufacturers and \$1.539 million in excise-equivalent duty¹ from importers of tobacco products in 2019/2020. There are three multi-national tobacco companies who account for the majority of imports, with approximately 30 commercial importers including embassies, duty free stores, ship providers. In 2018/19 there were between 40-60 private importers through fast freight, mail and sea freight.

Under the Customs and Excise Act 2018 (the Act), excise taxes on tobacco products are payable at the point of manufacture within New Zealand or when manufactured product is imported into New Zealand. Tobacco products are defined as manufactured when dried and cured tobacco leaf is cut for smoking. Tobacco leaf that has been dried and cured but not cut for smoking is not subject to import controls or excise tax but can only be further manufactured (including cutting) for smoking in a licensed Customs-controlled area.

From 1 January 2011, excise tax on tobacco products has increased by 10% annually in addition to the annual inflation adjustment as a health measure to discourage smoking. A final 10% increase as provided for in the Act will take place on 1 January 2020. The cumulative effect is that New Zealand has among the highest retail prices for tobacco products in the world. For example, the retail price of a typical packet of 20 cigarettes in New Zealand is around NZD \$31.00. The same packet in Vietnam costs NZD \$1.62, in China NZD \$5.29 and in South Korea NZD \$6.07.

Problem

The high retail price of tobacco in New Zealand has made smuggling lucrative. Customs' intelligence suggests that organised crime groups are selling Chinese branded cigarettes in New Zealand for \$10-\$15 per packet. Not only is there no excise tax and GST paid on this product, but its availability increases the accessibility and affordability of tobacco products and undermines tobacco control policies. These policies include the use of taxes to increase the price to reduce consumption, and selling tobacco products in plain packaging with the required health warnings.

The high retail price of cigarettes in New Zealand and low prices overseas has incentivised smuggling and illicit manufacture of tobacco using imported tobacco leaf. This profitability, combined with low risk, is driving organised criminal networks to smuggle cigarettes. Customs is facing problems with tobacco at the border in relation to the legislative settings for tobacco leaf and in Customs' ability to respond to tobacco smuggling through all import streams.

¹ When excisable 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).

Unlawful tobacco products are those that are imported with the intention of evading the payment of excise duty and GST and includes cigarettes that are mis-declared (deliberately described as other goods) or hidden, or tobacco leaf imported for illegal manufacture. There are large and increasing volumes of tobacco products being imported through the International Mail Centre (IMC). There have also been a number of large seizures of illegal tobacco products through sea freight and international air passengers, which have the hallmarks of organised crime.

Tobacco products (excluding tobacco leaf)

The indicators are that smuggling to avoid taxes has grown rapidly in the last 12-18 months off a historically low base and is on an upwards trajectory. The incidence of Interceptions of illicit cigarettes at the border has increased by 352 percent between 2015 and 2019, with 4 months still to go. Much of that increase is at the IMC where interceptions have increased during that same period by 233 percent.

The rate of increase is accelerating with a 53 percent increase in the number of interceptions in 2018 over 2017. The relative size (ie number of cigarettes involved) is also increasing. In the past, large interceptions (0.25 million or more cigarettes) were virtually unheard of at our border. Customs has recently seen a number of large seizures of cigarettes, which have the hallmarks of organised crime. For example:

- “shot-gun” type importations. These are large quantities of small packages addressed to post office boxes, being fraudulently used by the use either of false names or through innocent box holders being targeted. Package declarations are routinely mis-described to try to evade detection and excise tax. The cigarettes were declared as items such as toys, shoes or ornaments. For example:
 - In August 2019 at the IMC, there were the following interceptions: 250,000 cigarettes on one day, with a further 100,000 found the following Monday; 2086 packages containing 1 million cigarettes over a two-week period. 136 packages (54,400 cigarettes) went down the IMC processing belt in less than 10 minutes.
 - On 18 October 2019 over 100,000 cigarettes were intercepted at the IMC in one hour. All of these cigarettes were sent from China in packages containing 400 cigarettes.

Photo: some of the 2086 packages of cigarettes intercepted over two weeks at the International Mail Centre in August 2019



Photo: some of the 100,000 cigarettes intercepted over a one hour period at the International Mail Centre in October 2019



- Operation Iguana, involving registered mail from China addressed to post office boxes. **s 6(c) OIA**
[REDACTED]
- Operation Whitethorn (2018) involved cigarettes concealed in sea containers containing furniture for a furniture importer's business. **s 6(c) OIA**
[REDACTED]
- Operation Sphinx (2019). **s 6(c) OIA** [REDACTED] cigarettes were concealed inside boxes of foodstuffs for a food importer's business. **s 6(c) OIA**
[REDACTED]
- Increased frequency of smuggling through the airport using the same methods as drugs eg body packing.

Customs is facing significant challenges in stemming the flow of illicit tobacco. In the past 12-18 months, Customs has concluded or commenced six major illicit tobacco operations all conducted at the expense of other priorities and in some cases not conducted to the full extent, ie ending investigations at the border, with limited ability to follow through to asset recovery and to investigate/disrupt the distribution and retail chains. The current level of effort cannot be sustained into the future without risks to the Government's priorities in respect of illicit drugs.

The border processing system and its legislative framework are not designed for the volume of interceptions, and Customs is struggling to undertake its key functions at the IMC in particular as a result. Parcel volumes have increased from 10 million in 2014 to about 16 million in 2018. The amount of prohibited and dutiable goods requiring Customs action has also increased. Within that, tobacco requires significant work due to volumes and the requirements of legislated processes such as seizure and destruction, and recovery of duty (even though the goods are smuggled and likely, no duty will be recovered).

For example, it will require about 730 hours (91 days) of officer time, to carry out administrative processes around recording, effecting a legal seizure, storage and destruction of the goods in relation to the 2,086 packages of cigarettes intercepted at the IMC in two weeks in August 2019. Customs estimates that it cost about \$745,000 in 2018/19 to process tobacco seizures (excluding investigations and prosecutions). The companion Regulatory Impact Assessment focuses on the seizure process.

One of the key problems with the increasing volumes of smuggled cigarettes is that Customs does not know in advance of the importation who the importer is. This means Customs cannot manage the revenue risk. This is a particular issue at the IMC where no data is available for Customs to undertake any risk assurance.

Smuggling cigarettes is not like smuggling controlled drugs. Cigarettes are legally obtainable overseas, and there are no international treaties controlling trade or requiring co-operation to combat smuggling. Organised crime groups have strong incentives to target New Zealand due to the price differential between New Zealand and other countries, which results in high profit opportunities in a low risk environment. Customs expects individual importers of illicit tobacco will continue to import through the IMC due to the low cost of tobacco overseas. If the cigarettes are stopped by Customs, it makes financial sense to abandon that shipment and try again.

Tobacco leaf

Customs and the Ministry for Primary Industries are seeing imports of commercial quantities of tobacco leaf through the IMC which Customs suspect are for use in the unlicensed commercial manufacture of 'roll your own' tobacco or cigarettes to evade excise.

Photo: An example of the tobacco leaf being imported



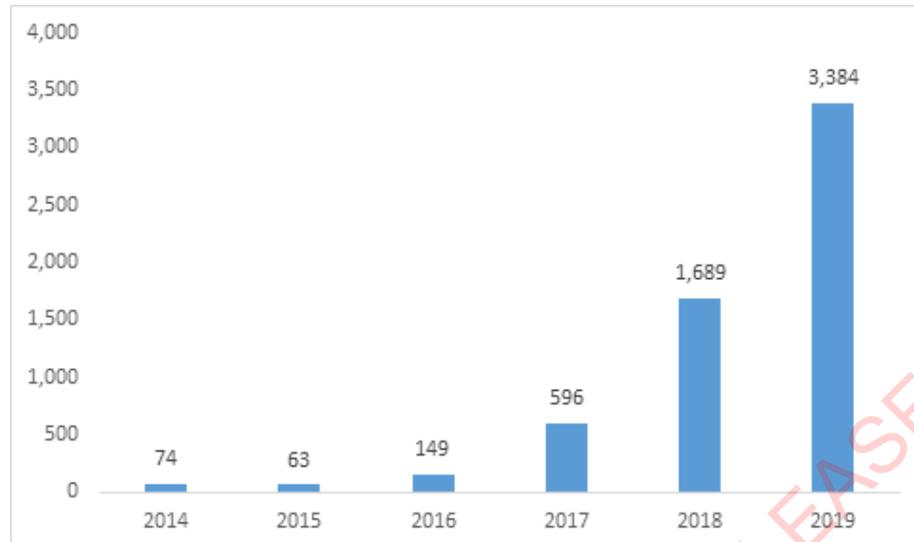
Customs is also seeing legal imports of grinders, liquids and empty filtered cigarette tubes which are likely used to turn the leaf into smokable tobacco and cigarettes.

Photo: Imports of grinders and empty filtered cigarette tubes



As illustrated in the graph below, imports have increased by 457 percent from 2014 to 2019 (September year to date). Monthly volumes are steadily increasing, peaking in the last month in the dataset (September 2019) at 821kg, 24% of the year-to-date for 2019.

Graph 1: Imports of tobacco leaf through the International Mail Centre 2014-2019



The nine months through September 2019 represent a:

- nearly 500% increase from 2017 to 2019 (468%)
- over 2,000% increase from 2016 to 2019 (2,177%).

The pattern is very similar to that of smuggled cigarettes: coming off a historically low base with the rate of increase accelerating rapidly in the past one-to-two years. At current rates, the 2019 amount will exceed 5,000kg representing between \$5-6 million in excise and GST potentially evaded if the leaf is cut into smoking tobacco.

To prove that illegal manufacture is taking place, Customs needs to collect information and intelligence on where the leaf is destined and who is manufacturing it. The importers are aware of the law and the key New Zealand website selling leaf ensures it does not convey that the product is for smoking. Given the frequency and wide geographical spread of these importers and the steps taken to hide what is happening, to find where the manufacture is taking place would be difficult and resource intensive. For example, in the 2019 year to date (September 2019) approximately 466 persons from Kerikeri to Bluff imported tobacco leaf. To investigate whether any of them are cutting the leaf into smoking tobacco (and avoiding paying excise) would require resources that would need to be taken from other priority work.

The objectives are to:

- identify importers of tobacco products and leaf prior to importation in order for Customs to undertake due diligence
- avoid revenue loss; restrict the availability of excise unpaid tobacco products to the general public
- ensure costs on compliant commercial importers are kept to a minimum
- encourage importers to legally import tobacco products (cigarettes and tobacco leaf) through appropriate channels.

2.2 Who is affected and how?

The target group are the individuals and organised crime groups considering or undertaking illegal importing activities in relation to tobacco products. There are likely to be individuals who will continue to illegally import tobacco products (ie, without a permit) to evade the payment of excise and GST because of the strong economic incentives. There is increasing evidence of the sophistication of the smuggling particularly in the sea cargo stream. This is likely to continue.

Those who wish to import tobacco products will need to apply for and have a permit approved before import. This will mean Customs knows in advance, who the importer is to manage the revenue risk.

2.3 Are there any constraints on the scope for decision making?

A constraint is that there is no scope within the current legislation to know in advance, who is importing tobacco products in order to manage the revenue risk. While the current legislation requires importers using the air and sea to provide Customs with some information about the goods to be imported, there is no requirement for mail. Under the International Universal Postal Union Agreement, of which New Zealand is a member, NZ Post gets some data from other postal authorities. At the current time, there is no mechanism for Customs to receive that data from NZ Post. There is also no current mechanism to use the data for risk targeting.

Customs has a Data in Mail project underway with NZ Post and MPI that is working on building the mechanism for NZ Post to provide Customs/MPI with the mail data. This data is still some time away and it may only cover commercial mail but not private mail initially. How well it will work will depend on the quality of the data.

There is an interdependency with the proposal to *Process to seize, store and dispose of tobacco imported illegally*.

Section 3: Options identification

3.1 What options have been considered?

Tobacco leaf

Three high level options were considered:

- a) No controls at the border. Excise is not payable on tobacco leaf as it is a raw material. To be manufactured into product for smoking, manufacture must be in a Customs-controlled area and excise paid (Status Quo)
- b) Introduce an excise tax on tobacco leaf at the border. On importation, excise-equivalent duty would apply
- c) Require importers of tobacco leaf to obtain a permit from the New Zealand Customs Service prior to importation.

Tobacco products

Two high level options were considered:

- a) Tobacco products are able to be imported across all import streams with excise-equivalent duty paid on importation (status quo)
- b) Make tobacco products subject to a permit regime.

The advantages and disadvantages of each option are described in Table 1 and the options assessed against the objectives in Table 2.

Table 1: Advantages and disadvantages of high-level options

Tobacco leaf

Option A: No controls on tobacco leaf at the border. (Status Quo).

Advantages:

- licensed manufacturers are able to import tobacco leaf for manufacture without any import controls

Disadvantages:

- tobacco leaf is imported to evade the payment of excise
- requires Customs to be able to find where unlicensed manufacturing is taking place which is resource intensive and imposes significant costs excise unpaid product is in the market

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Option B: Make tobacco leaf subject to excise-equivalent duty on importation. This would require an amendment to the Act. The following key features will apply:

- Licensed manufacturers who import leaf for further manufacture would pay only ad valorem duty and GST at import because they will pay excise duty once the tobacco is manufactured. Import declarations would include the relevant Customs-controlled area code, and the leaf would be required to be delivered to the licensed manufacturing area. Excise would be collected as currently upon removal of the manufactured product from the licensed manufacturing area for home consumption.
- Those importing without a licence would pay excise on importation.

<p>Advantages:</p> <ul style="list-style-type: none"> • revenue loss would be avoided as excise-equivalent duty would apply when the goods are imported 	<p>Disadvantages:</p> <ul style="list-style-type: none"> • creates additional administration costs to Customs and the current two compliant licensed manufacturers and any future licensed manufacturers who are importing leaf for further manufacture to complete and process the import declarations • leaf imported by licensed manufacturers would need to be stored in a Customs-controlled area. This could impose additional costs on the licensed manufacturers, as they may not have sufficient space in their licensed manufacturing area to store the leaf
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Option C: Controlled at the border. Importers of tobacco leaf would need to obtain a permit from the New Zealand Customs Service prior to importation. This can be achieved by an Order in Council under section 96 of the Act. An amendment to the Act should enact the features of the proposed prohibition order.

The following key features will apply:

- the chief executive can issue a permit if satisfied that the leaf will be imported by a licensed manufacturer, is required for a legitimate purpose, and will not be made into smokable product
- all permits will be issued subject to certain conditions or requirements specified in the permit, to be complied with by the permit holder
- the expiry date for the permit will be informed by the importers compliance history and risk
- the chief executive will have the ability to refuse an application for a permit
- to address the issues at the IMC, one of the conditions of any permit issued will be that tobacco products cannot be imported through international mail
- the chief executive will be able to revoke a permit if:
 - the holder of the permit does not comply with a condition or requirement of the permit or
 - revocation is necessary for the protection of the revenue or for ensuring compliance with the Act.

<p>Advantages:</p> <ul style="list-style-type: none"> • revenue loss would be avoided • the control measure can be introduced quickly to protect revenue through a prohibition order under section 96 of the Act followed by an amendment to the Act to reduce the risk of legal challenge • the current two licensed manufacturers will only need to apply for a permit once, the permit will be valid while they hold a Customs-controlled area licence to manufacture tobacco • provides pre importation information to assist in Customs performance of due diligence and management of revenue risk 	<p>Disadvantages:</p> <ul style="list-style-type: none"> • licensed manufacturers would incur a small additional one-off cost in completing the permit application form to apply to Customs for a permit to import tobacco leaf
<h2 style="color: #0070C0;">Tobacco products</h2> <p>Option A: Tobacco products can be imported across all import streams with excise-equivalent duty paid on importation. (Status quo). The following key features will apply:</p> <ul style="list-style-type: none"> • excise-equivalent duty is paid on importation • tobacco products imported as accompanied goods by passengers that are in excess of the passenger concession² can either be declared or abandoned. 	
<p>Advantages:</p> <ul style="list-style-type: none"> • a relatively simple regime imposing minimal compliance cost on importers and Customs 	<p>Disadvantages:</p> <ul style="list-style-type: none"> • relies on the majority of importers being voluntarily compliant • does not address the significant financial incentives to engage in unlawful activity (high profit opportunities, excise evasion combined with insufficient resource to engage at the border) • facilitates other activities of organised criminal groups involved in this activity; when smuggling tobacco and evading taxes, organised crime is able to channel profits into other illegal activities • Customs is not able to adequately risk assess activity in the international mail stream because unlike other import streams, the information does not become available in

² The passenger duty concession enables a passenger to bring into New Zealand free of GST and excise-equivalent duty: 50 cigarettes, or 50 grams of cigars, or 50 grams of tobacco products, or a mixture of all three weighing not more than 50 grams.

	<p>advance of importation</p> <ul style="list-style-type: none"> • processing of tobacco products imported through mail imposes high costs on Customs for virtually no returns as the vast majority are smuggling attempts with no intention to pay excise • the volume of illicit tobacco products imported through the mail route undermines Custom's ability to effectively and efficiently manage the risk to Crown revenue
<p>Option B: Make tobacco products subject to a permit regime with excise-equivalent duty paid on importation. The following key features will apply:</p> <ul style="list-style-type: none"> • a permitting regime can be achieved as an interim measure to address the urgent enforcement issues at the border by Order in Council under section 96 of the Act. An amendment to the Act should enact the features of the proposed prohibition order • the chief executive will be able to issue an ongoing permission to import tobacco products where it is considered that applying on a case by case permission is not necessary • importers will be required to apply to Customs in writing in advance of importation by completing an application with the required information for a permit to import tobacco. This would be a simple form containing applicant contact details, the type of tobacco product(s) they are seeking to import and the purpose of importing the goods eg personal, commercial • all permits will be issued subject to certain conditions or requirements specified in the permit, to be complied with by the holder of the permit. To address the issues at the IMC, one of the conditions of any permit issued will be that tobacco products cannot be imported through international mail • permits will be able to be used multiple times prior to the expiry of the permit. The expiry date for the permit will be informed by the importers compliance history and risk. As part of the regulatory design of the permit regime, Customs will work to keep compliance costs to a minimum • the chief executive will have the ability to refuse an application for a permit • no fee will be charged for a permit in order to minimise the costs of the new regime for those already compliant importers and because the measure is designed to secure Crown revenue • the chief executive will be able to revoke a permission if: <ul style="list-style-type: none"> ○ the holder of the permission does not comply with a condition or requirement of the permission or ○ revocation is necessary for the protection of the revenue or for ensuring compliance with the Act • tobacco products imported as accompanied goods by passengers and that are in excess of the passenger concession can either be declared or abandoned • the Order in Council will engage the offences and penalties for importation in contravention of the Order in Council. Any importation without a permit, or that does not comply with the conditions of the permit, would be subject to forfeiture (which is the case with smuggled tobacco currently). It would also be subject to criminal penalties (an infringement fine of \$400 for strict liability offending, or a maximum term of imprisonment of 6 months or a fine of up to \$20,000 for 	

deliberate breaches)

Advantages:

- revenue loss would be avoided
- by using section 96 of the Act import controls can be imposed almost immediately to deal with the significant issues at the border. Use of s 96 also engages the offences and penalties provisions in the Act to add further constraints to unlawful activity
- the prohibition order enables Customs to deal with urgent and presenting problems with smuggled tobacco until the Act can be amended to create a bespoke permitting regime
- Customs will identify importers of tobacco products before importation takes place and can perform due diligence to manage revenue risk prior to granting a permit
- no change for tobacco products imported as accompanied goods by passengers who will (as they are required to do currently) declare or abandon tobacco products in excess of the passenger concession
- will restrict the availability of excise unpaid tobacco products
- legitimate importers would not be unduly inconvenienced
- it will assist with managing revenue evasion. Any importation of tobacco products without a permit may then be seized by Customs without the need to consider matters such as whether the goods were packaged or described in ways to avoid the payment of revenue, or to use revenue recovery processes when it is likely the importer will not be able to be identified or be willing to pay. These current requirements impose significant costs on Customs even though the goods are smuggled
- it will reduce revenue evasion by increasing Customs' visibility on imports and closing off import channels used by

Disadvantages:

- the full benefits to Customs of the permitting regime will not be realised with the current seizure process. A proposal for an expedited seizure and disposal process on tobacco products is included in the companion regulatory impact assessment
- organised crime groups have strong incentives to target New Zealand due to the price differential between New Zealand and other countries, which results in high profit opportunities in a low risk environment. Customs expects individual illegal importers will continue to attempt to import through the IMC due to the low cost of tobacco overseas

smugglers	
<ul style="list-style-type: none"> the prohibition would be consistent with the principles of the World Health Organisation Framework Convention on Tobacco Control 	

Table 3: Assessment against objectives: Tobacco leaf

Objectives:	Option A	Option B	Option C
Identify the importers of tobacco leaf and refuse prior to importation in order for Customs to undertake due diligence	x	√√	√√
Avoidance of revenue loss; availability of excise unpaid tobacco products to the general public is restricted	xx	√√	√√
Costs on compliant commercial importers are kept to a minimum	√√	x	√√
Encourage importers to legally import tobacco products (cigarettes and tobacco leaf) through appropriate channels.	xx	√√	√√
Key:			
xx	x	√	√√
Strongly inconsistent with objective	Inconsistent with objective	Consistent with objective	Strongly consistent with objective

Table 3: Assessment against objectives: Tobacco products

Objectives:	Option A	Option B
Identify the importers of tobacco products prior to importation in order for Customs to undertake due diligence	xx	√√
Avoidance of revenue loss; availability of excise unpaid tobacco products to the general public is restricted	xx	√
Costs on compliant commercial importers are kept to a minimum	√√	√
Encourage importers to legally import tobacco products (cigarettes and tobacco leaf) through appropriate channels.	xx	√√
Key:		
xx	x	√
Strongly inconsistent with objective	Inconsistent with objective	Consistent with objective
Strongly consistent with objective	Strongly consistent with objective	Strongly consistent with objective

3.2 Which of these options is the proposed approach?

Tobacco leaf

Customs considers implementing option (c) is the best option. The status quo does not meet objectives. To prove that illegal manufacture is taking place, Customs needs to collect information and intelligence on where the leaf is destined for and who is manufacturing it. Given the frequency and wide geographical spread of where the consignments are addressed, to find where the manufacture is taking place is difficult and resource intensive. For example, there were 822 individual importations in the 2018/19 financial year.

Tobacco leaf must be subject to additional controls at the border due to the increasing levels of importation to manufacture tobacco products to evade excise tax, and the difficulties in proving this offending. It is necessary in the public interest to impose controls over imported tobacco leaf at the border due to the increasing levels of importation to manufacture tobacco products to evade excise tax, and the difficulties in proving this offending. The most efficient and cost effective option is option (c) as it meets all of the criteria. It imposes a one-off minimal cost on the two licensed manufacturers and prohibits all other imports of leaf unless Customs is satisfied that the leaf is required for a legitimate purpose and would not be made into smokable product.

Tobacco products

Customs considers implementing option (b) is the best option as it meets all of the criteria. The status quo does not meet the objectives as Customs is facing significant challenges in stemming the flow of illicit tobacco. Smuggling to evade taxes has grown rapidly in the last 12-18 months off a historically low base and is on an upwards trajectory. The incidence of interceptions of illicit cigarettes at the border has increased by 352 percent between 2015 and 2019, with 4 months still to go. The rate of increase is accelerating with a 53 percent increase in the number of interceptions in 2018 over 2017. The amount of tobacco product involved in each interception is also increasing. In the past, large interceptions (eg 0.25 million or more cigarettes) were virtually unheard of at our border.

The border processing system and its legislative framework are not designed for the volume of interceptions, and Customs is struggling to undertake its key functions at the IMC in particular as a result. Organised crime groups have strong incentives to target New Zealand due to the price differential between New Zealand and other countries which results in high profit opportunities in a low risk environment. Customs expects individual importers will continue to import through the IMC due to the low cost of tobacco overseas.

The Order in Council is necessary in the public interest. Tobacco products are highly taxed for public policy reasons and to reflect the negative health impacts and costs of tobacco consumption on individuals and society. Smuggled tobacco is part of an increasing black market to evade tax. The purpose of the Order is to tighten border controls to reduce revenue evasion and improve the accuracy of import data to comply with New Zealand's World Health Organisation commitments. Legitimate importers would not be unduly inconvenienced.

A permitting regime will assist with managing revenue evasion. Any importation of tobacco products without a permit may then be seized by Customs without the need to consider matters such as whether the goods were packaged or described in ways to avoid the payment of revenue, or to use revenue recovery processes when it is likely the importer will not be able to be identified or be willing to pay. The permit regime will ensure Customs is aware of the identity of legitimate importers of tobacco products before importation takes place and can perform due diligence to manage revenue risk prior to granting a permit.

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Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties (identify)	Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	Impact <i>\$m present value, for monetised impacts; high, medium or low for non-monetised impacts</i>
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Additional costs of proposed approach, compared to taking no action

Importers of tobacco products	<p>Importers will need to apply for a permit prior to importation. The application will be a short simple document. The validity period for the permit will be based on the applicant's compliance history. If a permit is refused or the importer does not apply for a permit, and they import tobacco products without it, the goods will be seized at the border.</p> <p>Importers who currently legally import tobacco products through the IMC will no longer be able to use that import stream. Other import streams may be slightly more expensive, although that will depend on a number of factors.</p>	<p>Low – small administration cost in:</p> <ul style="list-style-type: none"> • applying for a permit (no application fee) • understanding the new requirements • increased cost to private individuals importing for their own use, as they will no longer be able to use the mail stream. They will incur an increased freight cost and fast freight clearance fee using fast freight rather than the mail stream. This is likely to only affect a small number, as there are not many private individuals who are currently importing and paying excise.
Users of tobacco leaf and refuse for other than smokable goods	<p>Users of tobacco leaf for other than smokable goods can apply to Customs for a permit. The application will be a short simple form with sufficient evidence to satisfy Customs that the leaf will be used for other than smokable goods. The nature of that evidence may vary from case-to-case.</p>	<p>Low – small one-off administration cost in:</p> <ul style="list-style-type: none"> • applying for a permit (no application fee) • understanding the new requirements.
Customs	<p>Customs will incur costs of setting up and administering the permitting regime.</p>	<p>Medium: total operating expenditure per annum \$215,703 in 20/21 and</p>

		outyears
Total Monetised Cost		\$215,703 in 20/21 and outyears
Non-monetised costs		Low

Expected benefits of proposed approach, compared to taking no action		
Importers of tobacco products	The proposal will ensure a level playing field as all importers will require a permit.	Low
Manufacturers	The proposal will ensure a level playing field as all tobacco manufacture will be undertaken in a licensed manufacturing area and excise paid.	Medium
Users of tobacco leaf and refuse for other than smokable goods	The permitting regime will enable the chief executive to issue a permit if satisfied that it is required for a legitimate purpose and would not be made into smokable product.	Low
Customs	<p>Customs will know in advance of importation who the importer is and will be more able to manage the revenue risk. This data can be used for risk assessment purposes.</p> <p>The proposal will discourage smuggling by making it clear any tobacco products imported without a permit and found by Customs will be destroyed and if you have a permit Customs will follow up on revenue collection. It is unclear by how much. The principal benefit will be the prevention of revenue loss.</p> <p>s 9(2)(g)(i) OIA</p>	<p>Medium</p> <p>Greater assurance that the current \$2 billion in excise will be collected from importers by eliminating people who will not pay and having due diligence over who importers are.</p> <p>Clearly separates what is legal over what is illegal at the point of importation.</p>
Total Monetised Benefit		Cannot calculate monetarised benefits
Non-monetised benefits		Low-medium.

4.2 What other impacts is this approach likely to have?

No other potential impacts identified.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

Industry has previously asked the government to do more about the illicit market for tobacco products. Targeted consultation has taken place with the major importers of tobacco products and one manufacturer of tobacco products within New Zealand who import tobacco leaf for further manufacture. These parties support the preferred option and note that it will have minimal impact on legitimate commercial importers.

Due to urgency and the need to not alert smugglers to weaknesses in border control, it has not been possible to consult smaller commercial and private importers of tobacco products. It is our assessment that this proposal will have no negative impacts compared to the status quo on any legitimate importer of tobacco products.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

The preferred option requires increasing import restrictions on tobacco products including tobacco leaf by making them a prohibited import. This can be done as an interim measure through a prohibition order under section 96 of the Act. It is planned that it come into effect early in 2020. This should be seen as a short-term solution to address the urgent enforcement issues at the border. An amendment to the Act to enact the features of the proposed prohibition orders should be progressed.

There is a risk that if the changes to tobacco importation requirements do not become well known that seizures will increase in the short-run until awareness improves. To reduce this risk, implementation will be supported by an education and information programme aimed at discouraging the illegal importation of tobacco products and at raising awareness of the proposed new requirements to obtain a permit to import tobacco products.

There are no other significant implementation risks.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

Customs' has a draft regulatory plan that contains monitoring, evaluation and review of the border protection regulatory system under the Act 2018.

Data is already collected on system level impacts and on enforcement. Customs will set up a system to monitor the permitting regime. This will include data relating to the permitting regime.

No new or additional data needs to be collected to enable the financial impacts to be measured.

7.2 When and how will the new arrangements be reviewed?

This proposal is part of a programme of measures to reduce the risk of revenue loss to the Crown from tobacco smuggling. That whole programme will be subject to regular review and update as the market for illegal tobacco products and its suppliers reacts and adapts to the various controls that are put in place.

A number of successful applications for compensation would signal a need for Customs to review its procedures when seizing tobacco products.

Customs holds annual or when required meetings with key excise stakeholders. Stakeholders can also raise any issues outside of the process.

PROACTIVELY RELEASED