

Impact Summary: Process to seize, store and dispose of tobacco imported illegally

Section 1: General information

Purpose
<p>The New Zealand Customs Service (Customs) is solely responsible for the analysis in this Regulatory Impact Assessment.</p> <p>This analysis has been produced to inform decisions to be taken by Cabinet on the imposition of strengthened controls over tobacco products and tobacco leaf imported into New Zealand. The purpose of those controls is to minimise the risk to Crown revenue from the smuggling of tobacco products to avoid the payment of Excise Equivalent Duty and Goods and Services Tax. This Regulatory Assessment considers options in relation to the <i>process to seize, store and dispose of tobacco products and tobacco leaf imported illegally.</i></p>

Key Limitations or Constraints on Analysis
<p>A limitation on the analysis is that the estimate of the possible cost savings from a simplified seizure process is based on the past pattern of importations of tobacco products and tobacco leaf under current regulatory settings. We do not know how importers of tobacco products and tobacco leaf will respond to new import controls, and in particular if the level of smuggling will change significantly or if it will move between import pathways. 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 study estimated that illicit tobacco consumption increased from 9.2% to 10.2% of total consumption between 2107 and 2018. There are reasons to believe that the methodology used gives an over-estimate.</p> <p>A constraint on the analysis is that it has only been possible to consult with the major importers and manufacturers of tobacco products and major importers of tobacco leaf due to the urgent need to prevent exploitation of gaps in border controls by smugglers.</p>

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Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

Under the Customs and Excise Act 2018 (the Act) imported and/or excisable goods can be seized by Customs (and subsequently condemned to the Crown for destruction or disposal) for a variety of reasons such as revenue fraud, or because the goods are a prohibited import.

Unlawful tobacco products which is defined here to include cigarettes, pipe and hand rolling tobacco, but not cigars and similar products are those that are imported with the intention of evading the payment of excise-equivalent duty¹ 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 and tobacco leaf being imported through the International Mail Centre (IMC).

Under the Act a particular process to effect a legal seizure is required. A notice must be given to the importer advising of the seizure and of their right, on request, to have the seizure reviewed by the chief executive and, if unsatisfied with that decision, their right to make an appeal to the Customs Appeal Authority (CAA). Certain time limits are specified for the importer to seek a review of a seizure and for the chief executive and the CAA to make a decision. At the end of the process, and if the seizure is confirmed, the goods are forfeit to the Crown and may be destroyed or otherwise disposed of. Customs stores the goods while these processes are carried out (in some cases the goods are stored in a Customs-controlled area (CCA) at the cost of the operator of that CCA). The storage could be for as little as one month, if the importer does not contest the seizure, and up to six months if an appeal to the CAA is made.

Customs estimates that it cost about \$750,000 in the 2018/19 financial year to administer the seizure process over illegal tobacco products. Note that these costs only relate to processing, storing and disposing of illegal tobacco products as part of the seizure process and do not include the costs of investigating or prosecuting offending. All seized tobacco products have to be securely stored pending the possibility of review and appeal. This is particularly an issue at the IMC where there are frequent small-scale interceptions.

The costs to Customs of processing and storing large volumes of seized tobacco products are excessive in relation to the probability of the goods being returned to the importer following a review of that seizure. This is because the majority of the seized goods are illicit (smuggled) tobacco. For example, 2086 packages found to contain cartons of cigarettes were recently intercepted over a two week period at the IMC. It will take the equivalent of 91 person days (730 hours) to put these packages through the seizure process.

Customs has taken steps to streamline the seizure process within the current legislative framework to make it as efficient as possible. This includes developing and implementing technology tools to pre-populate systems, letters and notices, and reducing duplication in handling and paper work requirements, without jeopardising any subsequent processes (eg,

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).

appeals, investigations or prosecutions). These improvements have made some gains but costs remain high and are growing. Moreover the current seizure process seldom results in the payment of the due excise and GST on tobacco products and almost never results in the detained goods being returned to the importer.

The volume of tobacco products having to be dealt with through the seizure process will potentially increase under the proposal to make tobacco products and tobacco leaf prohibited imports under the Act (unless a permit has been issued by Customs), and the related proposal to not make permits available for importation through the IMC. This is because it is proposed that tobacco leaf imported through the IMC, which is not currently seized will be seized in the future. There were 822 individual importations of tobacco leaf through the IMC in the 2018/19 financial year.

Therefore if nothing is done to further streamline the seizure and related administrative processes the costs are expected to rise in the future. All possible process improvements within the current legislative framework have been made, and further cost savings can only be achieved through a change to the legislative framework itself. Non-legislative options (eg, education and information programmes) will not achieve behaviour changes to stop the illegal importation of tobacco products, and therefore will not reduce the impact on Customs' resources and other priorities.

This RIA analyses options in respect of changes to the Act to reduce the costs of administering the seizure process as it relates to the seizure of unlawfully imported cigarettes and tobacco leaf.

The objectives are to rationalise the seizure process as much as possible in order to:

- reduce the costs of processing and storing illegally imported tobacco products and tobacco leaf when there is a very low likelihood of collecting the tax owed
- encourage importers to legally import tobacco products and tobacco leaf through appropriate channels
- allow appeals and compensation for wrongful seizure and destruction of the goods.

2.2 Who is affected and how?

The status quo and the options for change principally impact on Customs through the potential for cost savings in the form of reducing resource requirements for processing and storing illegal tobacco products.

The owners and operators of some CCAs are affected to a lesser extent as from time-to-time they are required to bear some of the costs of managing illegal tobacco products through providing storage facilities that they are not legally entitled to be compensated for.

Also affected are the individuals and organised crime groups considering or undertaking the illegal importation of tobacco products and tobacco leaf. There are likely to be individuals and groups who will continue to illegally import tobacco products and leaf (ie, without a permit) to evade the payment of excise and GST because of the strong economic incentives.

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

A constraint is that options are restricted to a tailored seizure process for tobacco products and leaf. Tobacco products (and the smuggling of them) have characteristics which supports a further simplified seizure process that do not apply to other categories of goods subject to seizure:

- tobacco products are illegally imported to evade revenue and as they cost so little in the source country the importer is happy to abandon them if they are intercepted and to avoid being identified
- there are considerations such as collectible, heirloom or historic values that can apply to some categories of goods subject to seizure under the Act (for example), that justify a review or appeal process that would take into account factors such as that the loss and destruction of the product would outweigh the gravity of the offending. Such factors do not apply to tobacco products.
- the sheer volume of importations make tobacco a particular problem especially in respect of storage costs. The high rates of taxation of tobacco products in NZ relative to source countries such as China, Vietnam, South Korea and the Philippines mean that the incentives to smuggle are going to remain strong for the foreseeable future.

There is an interdependency with the proposal to make tobacco products and tobacco leaf prohibited imports except under a permit issued by the chief executive, and to not issue permits to import through the IMC. The aim of these proposals are to remove cigarettes and tobacco leaf from the IMC pathway and reduce the volume of smuggled tobacco products coming through other pathways as importers will have to interact with customs brokers, fast freight operators or Customs directly.

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Section 3: Options identification

3.1 What options have been considered?

Three options were considered:

- a) A simplified seizure process for illegally imported tobacco products and tobacco leaf that requires:
 - a written notice to the importer within seven days of the seizure stating that the goods have been seized and have been destroyed
 - the importer would have a right to seek compensation for the customs value of the goods in the event that Customs seized them in error (ie when the person had a valid permit to import)
 - seized tobacco products and leaf would be destroyed as soon as possible (this could be as soon as on the date of seizure (if no follow up action is to be taken) or up to a month later.
- b) The same process as in option (a) but with no right to compensation.
- c) Continue to use the existing seizure process (status quo).

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

Table 1: Advantages and disadvantages of options

Option A:	
<p>Advantages:</p> <ul style="list-style-type: none"> • Reduction in costs (storage especially) and promotes effective use of resources with no reduction in expected revenue (as non-compliant importers do not intend to pay) • Reinforces expectation that legitimate importers will apply for a permit and pay due revenue • Provides a right of appeal for compensation for legitimate importers while reinforcing that the product is not unique or special that could justify an appeal for it to be returned 	<p>Disadvantages:</p> <ul style="list-style-type: none"> • Decisions on potential for further investigation and prosecution will need to be made quickly so appropriate evidence can be retained • Legislation change required
Option B:	
<p>Advantages:</p> <ul style="list-style-type: none"> • Reduction in costs (storage especially) and promotes effective use of resources to fairly 	<p>Disadvantages:</p> <ul style="list-style-type: none"> • No right to compensation for legitimate importers would be unreasonable in the

<p>apply the seizure process with no reduction in expected revenue (as no intent to pay)</p> <ul style="list-style-type: none"> • Further reduces administration costs (compared to Option A) by not providing a right of appeal • Reinforces expectation that legitimate importers will apply for a permit and pay due revenue 	<p>event that Customs seized the goods in error</p> <ul style="list-style-type: none"> • Decisions on potential for further investigation and prosecution will need to be made quickly so appropriate evidence can be retained • Requires legislation change
Option C: (Status Quo)	
<ul style="list-style-type: none"> • No legislation change required 	<ul style="list-style-type: none"> • Does not address the costs of applying the process to illegally imported tobacco products which are expected to continue to grow in volume • The resource required to process seizure notices is not available to focus on goods where there is more likelihood of collecting revenue and interacting with importers who want their goods

Table 2: Assessment against objectives

Objectives:	Option A	Option B	Option C
Encourage importers to legally import tobacco products and tobacco leaf through appropriate channels	√√	√√	xx
Streamline the seizure process for illegally imported tobacco products and leaf when there is a very low likelihood of collecting the due revenue and tax	√√	√√	xx
Allow reasonable rights of appeal for a wrongful seizure by Customs	√√	xx	√√
Key:			
xx	x	√	√√
Strongly inconsistent with objective	Inconsistent with objective	Consistent with objective	Strongly consistent with objective

3.2 Which of these options is the proposed approach?

Customs considers implementing option (a), a simplified seizure process with immediate destruction, supported by a right to seek compensation in the event an error was made is the best option.

The status quo is not viable as Customs has already made process improvements to release resources to manage the growth in volume at the IMC generally and the gains achieved from this will not be sufficient to manage the expected volume growth in tobacco seizures.

The key benefit from the preferred option is the reduced administration and storage costs for dealing with seized illegal tobacco products and leaf. This is a particular issue at the IMC. The cost savings would be in the form of freeing up resources for other priorities and to manage volume growth through all import streams and a reduction in storage costs. It is estimated that compared to the status quo the preferred option will reduce the process/storage time from seizure to destruction from a period of up to six months under the status quo to a period from immediately on the date of seizure to a maximum of a month.

In monetary terms it is estimated that the preferred option would reduce Customs' processing costs (based on the volumes of illegal tobacco processed over 2018/19) by between 10 and 20% or between \$75,000 and \$150,000 per annum. This estimate will be on the low side if the proposal to make tobacco leaf illegal to import without a permit is implemented and if the smuggling of tobacco leaf continues to take place, which is likely.

Compared to the status quo, the additional cost would be that of any compensation paid to an importer when tobacco products or leaf are destroyed in error. Under the status quo there is no compensation payable and instead the goods are released from storage back to the importer. Customs considers the compensation would rarely be payable. It is proposed that a Departmental Other Expenses appropriation of \$10,000 a year in Vote Customs for compensation for confiscated tobacco products be created if the Act is amended. This has been used as an estimate of the annual cost but it is considered on the high side.

The owners and operators of some Customs-controlled areas would also benefit under the preferred option compared to the status quo to the extent that the reduced storage times for seized tobacco products would reduce costs in those circumstances where from time-to-time they are required to provide storage facilities that they are not legally entitled to be compensated for under the Act. These cost savings cannot be reliably estimated due to the infrequent/irregular nature of this circumstance.

Section 4: Impact Analysis

4.1 Summary table of costs and benefits

Affected parties	Comment	Impact
Additional costs of proposed approach, compared to taking no action		
Importers of tobacco products	Linked to the proposal to make all imports of tobacco products illegal except under a permit, importers of tobacco products may have products seized and destroyed in error and will incur administrative costs to seek compensation. The compensation will be in the form of the customs value of the goods which includes costs such as freight, insurance and transport.	Low – the assumption is that there will be very few of these claims.
Customs	<p>Customs will incur costs of responding to compensation applications. This will build on an existing process rather than requiring a new process.</p> <p>There will be the costs of paying compensation.</p>	<p>Low - the assumption is that there will be very few of these claims.</p> <p>A compensation appropriation of \$10,000 per annum will be created in Vote Customs. This has been used as an estimate of the annual cost but it is considered on the high side.</p>
Total Monetised Cost		\$10,000 per annum Present value of costs over five years is \$42,124.
Non-monetised costs		Low

Expected benefits of proposed approach, compared to taking no action		
Importers of Tobacco Products	The proposal will have no impact on importers of legal tobacco products.	-
Customs	<p>It is estimated that Customs' processing costs (based on the volumes of illegal tobacco processed over 2018/19) would reduce by between 10 and 20%.</p> <p>This estimate will be on the low side if the proposal to make tobacco leaf illegal to import without a permit is implemented and if the smuggling of tobacco leaf continues to take place, which is likely.</p>	<p>Between \$75,000 and \$150,000 per annum.</p> <p>Present value of benefits of between \$316,000 and \$632,000 over five years.</p>

CCA operators	The owners and operators of some Customs Controlled Areas will benefit compared to the status quo to the extent that the reduced storage times for seized tobacco products would reduce costs in those circumstances where from time-to-time they are required to provide storage facilities that they are not legally entitled to be compensated for under the Act.	These cost savings cannot be reliably estimated due to the infrequent/irregular nature of this circumstance but are expected to be low as the occurrence of these circumstances is infrequent.
Total Monetised Benefit		Present Value of between \$316,000 and \$632,000 over five years. Net Present Value of between \$274,000 and \$590,000 over five years.
Non-monetised benefits		<i>Low</i>

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?

Targeted consultation has taken place with the major importers of tobacco products and one of the manufacturers 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 no 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 an amendment to the Act.

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 and tobacco leaf.

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' financial system will monitor the financial impacts of the new seizure process.

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.