**Regulatory Impact Statement**

**Options to Reduce New Zealand’s Duty-free Tobacco Concessions**

**Agency Disclosure Statement**

This Regulatory Impact Statement has been prepared by the Ministry of Health in consultation with the New Zealand Customs Service, The Treasury, Ministry of Business, Employment and Innovation, and the Ministry of Foreign Affairs and Trade.

This paper provides an analysis of options for reducing or removing duty-free tobacco concessions or allowances. The current concessions are:

* the international traveller’s ‘duty-free’ allowance[[1]](#footnote-1)
* the ‘gift’ allowance
* the ‘home-grown’ allowance.

The analysis in this Regulatory Impact Statement was constrained by two factors:

* the urgent nature of the analysis - it was undertaken in April 2014 to meet Budget 2014 timeframes at short notice[[2]](#footnote-2); and
* a lack of detailed information on both the size of the incoming traveller’s duty-free market and the quantity of home grown tobacco currently being produced in New Zealand.

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### Executive Summary

1. This regulatory impact statement provides an analysis of options for reducing or removing three duty-free tobacco concessions / allowances. Duty-free tobacco allowances are anomalies that undermine the Government’s drive to reduce tobacco consumption and smoking rates through excise tax increases.
2. There are three concessions that exempt tobacco from taxes – the incoming travellers’ duty-free allowance, the gift allowance and the home grown personal use allowance. These allowances prevent the Government from influencing the price of tobacco products through excise increases.
3. Reducing or removing the travellers’ duty-free allowance will impact on both duty-free stores and airport companies however the size of this impact is largely unknown. Duty-free sale to outbound passengers will not be affected.
4. If the traveller’s allowance was removed altogether the Treasury have estimated that Government revenue would increase by up to $50 million per annum.
5. The preferred options are aligning the incoming traveller’s duty-free allowance with that of Australia (50 cigarettes or 50 grams of tobacco), removing the gifting allowance entirely and reducing the ‘home-grown’ allowance to 5kgs.
6. New Zealand will need to address our international obligations with regard to three Customs instruments that refer to duty-free tobacco limits.

### Status quo and problem definition

1. There are currently three concessions which exempt tobacco products from excise duty and GST. These are:
* **The traveller’s duty-free allowance.** Incoming international travellers can bring up to 200 cigarettes, 250 grams of tobacco, 50 cigars (or a mixture of all three weighing up to 250 grams) into New Zealand free of duty and GST.
* **The gift allowance.** Tobacco products sent to New Zealand as a gift from abroad are exempt from duty and GST, providing the gift is below the value of $110.
* **The ‘home-grown’ allowance.** Individuals may manufacture up to 15kg of home-grown tobacco per adult per year for personal use. This equates to between 50 and 100 cigarettes per person per day, depending on tobacco content.
1. Tobacco excise is controlled through the Customs and Excise Act 1996. The Customs and Excise (Tobacco Products: Budget Measures) Amendment Act 2012 introduced four annual (1 January 2012-16) 10 percent increases in excise duties for tobacco. Modelling undertaken by the Treasury indicated that the excise increases (along with a previous increase in April 2010) would take a standard packet of 20 cigarettes to over $20 a pack or $1 per stick in 2016.
2. Reference 82(a) of Part II of Schedule 1 of the Tariff Act 1988 sets out the current incoming passengers allowance for ‘duty-free’ tobacco.

*The following goods (not being goods carried on behalf of any other person or* persons *and not being goods for sale or exchange) that are the personal property of a passenger, or member of the crew of a ship or aircraft, who is 17 years of age or over, and that accompany that person through Customs arrival processes:*

*Either 200 cigarettes, or 250 grams of tobacco, or 50 cigars, or a mixture of* cigarettes*, tobacco, or cigars that weighs not more than 250 grams.*

1. Reference 75 of Part II of Schedule 1 of the Tariff Act 1988 provides that gifts sent from persons abroad to persons resident in New Zealand that do not exceed $110 in total value are free of duty and GST.
2. Section 68A of the Customs and Excise Act 1996 provides for the home grown allowance.

**68A Exemption for tobacco manufactured for personal use**

(1) [Section 68](http://legislation.govt.nz/act/public/1996/0027/latest/link.aspx?id=DLM378608) does not apply to the manufacture of tobacco in a private house or dwelling place, but only if and as long as the conditions specified in subsection (2) are met.

(2) The conditions are as follows:

(a) the tobacco must be manufactured by an individual (the **individual**) who is 18 years or older:

(b) the individual must manufacture the tobacco in the individual’s private house or dwelling place, for the individual’s personal use and not for sale to any other person:

(c) the leaves or plants used in the manufacture of the tobacco must have been grown—

(i) on the land on which the individual's private house or dwelling place is located; and

(ii) for the individual’s personal use and not for sale or other disposition to any other person:

(d) the amount of manufactured tobacco that is manufactured in the individual’s private house or dwelling place, in any year ending with 30 June, must not exceed 15 kilograms

1. Raising the price of tobacco through excise tax increases is an important component of the Government’s tobacco policy. The excise increases, however, do not apply to duty-free tobacco products. As the domestic price of tobacco rises, duty-free prices will become increasingly inconsistent with one component of the Government’s tobacco policy. As the price differential increases it provides more incentive for travellers to purchase duty-free tobacco every time they travel. By 1 January 2016, excise duty and GST would make up over 75 per cent of the price of a packet of $20 cigarettes. Travellers could buy and sell on a carton of cigarettes to subsidise their travel costs. Avenues for cheaper tobacco products are not desirable or consistent with Government policy.

### Objectives

1. The objective of this analysis is to address the way that tobacco concessions undermine the Government’s policy of using increased tobacco taxes to increase the price of tobacco products, in order to reduce consumption and smoking related harm.
2. Although there are no set prices for tobacco products (these are set by the tobacco industry) the three tobacco concessions identified in this paper remove the Government’s ability to control the minimum or floor price of tobacco products in all parts of the supply chain through taxation. The concessions as they currently stand have the potential to provide an avenue of cheap tobacco for smokers in New Zealand and undermine the Government’s health and tax policy.

### Option and impact analysis

### *International Traveller’s ‘duty-free’ allowance*

1. New Zealand does not collect data on the number of passengers carrying ‘duty-free’ tobacco across the border or where they purchase the tobacco. Australia has undertaken surveys that indicate about 25 percent of arriving passengers carry tobacco, of which 72 percent is purchased overseas. The New Zealand Customs Services (‘Customs’) estimates, based on the Australian surveys, that around 20-25 percent (approximately 1 million people a year) of inbound passengers carry tobacco across the border. The 2013 Census results show that 15.1 percent of the New Zealand population are daily smokers.
2. Any reduction in the duty-free allowance would likely require reservations to be entered into in relation to three Customs instruments that refer to duty-free limits.
3. This paper analyses four potential options in relation to the incoming traveller’s duty-free allowance:
4. No change to the allowance (i.e. 200 cigarettes, 250 grams of tobacco, 50 cigars (or a mixture of all three weighing up to 250 grams)
5. A reduction to 50 cigarettes or 50 grams of tobacco (that would align New Zealand with Australia)
6. Zero concession (that is, no amount allowed in).
7. Zero concession with an open pack allowance (that is, the ability to bring in one open pack of up to a specified number of cigarettes, for example 24)

### *Status Quo - no change to the concession*

1. There is no strong policy rationale for the status quo, other than the existence of international agreements that provide for duty-free allowances. As domestic retail tobacco prices increase due to the increases in tobacco excise duty being passed onto consumers by the tobacco industry we are likely to see an increase in the sales of duty-free tobacco (if the price differential increases as expected). Passenger numbers are also increasing so this will also increase the volume of duty-free tobacco.
2. Having this avenue of cheap tobacco available is an anomaly and is inconsistent with Parliament increasing tobacco excise. Not only does the status quo undermine health and tax (and revenue) policy but it will also likely have an impact on timely passenger clearance due to the need for Customs to intervene to ensure compliance with the limit.
3. Customs will also face a growing administrative and cost burden to dispose of abandoned tobacco.
4. International interceptions of tobacco products at airports grew by 9.2 percent between 2011 and 2012. Passenger numbers only grew 3.9 percent over the same period. Table One shows the number of interceptions (above duty-free limit) at New Zealand international airports. Assuming an hour of time for each interception, airport tobacco interceptions equate to an approximate minimum of 2000 hours per year.

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| Table One: Tobacco interceptions at New Zealand International Airports  |
|  | 2011 | 2012 |
| Type of good | Number of interceptions | Amount intercepted | Number of interceptions | Amount intercepted |
| Cigarettes and Cigars | 1, 683 | 508,424 sticks | 1,838 | 600,435 |
| Loose tobacco | 314 | 184,761 grams | 343 | 228,891 |

1. No domestic legislation change or reservations to any international convention would be required if New Zealand were to stay with the status quo.

### *Reducing the duty-free allowance to 50 cigarettes or 50 grams of tobacco (that would align New Zealand with Australia)*

1. This option retains an entitlement to a duty-free allowance, but reduces the limit. Australia introduced its reduced limit for their duty-free concession on 1  September 2012. Inbound travellers are now only able to bring in 50 cigarettes or 50 grams of cigars or loose tobacco. The previous limit was 250 cigarettes or 250 grams of cigars or tobacco products. This number was 50 cigarettes higher than the New Zealand limit.
2. A reduction to the same limit as Australia would allow for a consistent trans-Tasman approach. Given that nearly a half of all passengers coming to New  Zealand come from (or via) Australia having similar well understood limits should require less passenger education, compliance and enforcement activities than removing the concession altogether.
3. Customs envisages that this option would likely create some short term impacts on clearance of travellers due to increased interaction with passengers to ensure compliance and to dispose of abandoned tobacco above the concession.
4. This option would require an awareness campaign and would have some resource implications for administration and compliance activity. A reduction in the allowance to align with the Australian levels would still allow a residual amount of duty-free consumption but would largely remove the incentives for inbound travellers to stockpile duty-free tobacco. This option would also limit compliance costs for inbound travellers travelling with small quantities of tobacco for personal consumption.
5. Reducing the limit would allow duty-free stores to continue to sell duty-free tobacco to incoming travellers albeit at a much lower level.

### *Removing the duty-free allowance - zero concession*

1. Removing the allowance entirely is the purest solution, as it will completely remove the current price differential between domestically purchased tobacco and duty-free. In this regard, this option is likely to be most consistent with the Government’s goal to make New Zealand effectively smoke-free by 2025. In practice however, the marginal impact on consumer behaviour under this option is unlikely to be materially different to that from a substantially reduced allowance.
2. Removing the allowance would be expected to have the greatest impact on duty-free retailers and airport companies in New Zealand, as it would eliminate the inbound market for duty-free tobacco. The relative size and importance of the *inbound* market to the commercial operators is unknown but is likely to be a significant source of earnings. Under any of the regulatory options presented in this paper, duty-free retailers would still be able to sell duty-free tobacco to *outbound* international passengers although many of these are travelling to Australia where the proposed duty-free limit applies.
3. A zero concession raises issues in relation to how to deal with passengers who may be travelling with an open pack of cigarettes.
4. This option would likely cause short-term impacts on clearance of travellers due to increased Customs interaction with passengers to ensure compliance with the new rules and to dispose of all tobacco carried by passengers. It can be expected that the level of compliance activity and ongoing passenger education required to administer this option will be much greater in comparison with options which allow for some tobacco to be imported duty-free by passengers.
5. This option would have resource implications for administration, compliance activity and would require an awareness campaign.

### *Removing the duty-free allowance but with an open pack allowance (or de minimis)*

1. This option would adopt a pragmatic approach whereby incoming passengers would be allowed to bring in one open partially consumed packet of cigarettes (or an equivalent amount of loose tobacco) duty-free. Although pack sizes vary internationally, by far the most common pack in New Zealand is 20 cigarettes. Hong Kong currently allows an open pack of up to 19 cigarettes to be brought in.
2. This option allows for very small quantities of tobacco to be carried over the border for personal use. One issue which would need consideration is what number of cigarettes should be allowed. Packs sizes vary around the world. In New Zealand packs of 20 make up the majority of the market whereas in Australia packs of 25 are more prevalent.
3. There would likely be short term impacts on clearance of travellers due to increased interaction with passengers to ensure compliance. While not expected to have the level of impact on administration and compliance that a zero limit would have, this option would require more administrative effort in comparison to the option of aligning with Australia’s duty free limit (due to the amount of trans-Tasman travel).
4. This option would have resource implications for administration, compliance activity, and would require an awareness campaign.

### *The Gift Concession*

1. The International Mail Centre handles approximately 4000 tobacco consignments of declared tobacco imports every year, of which around 8 percent are genuine gifts. This number is probably so small because most smokers are unaware of this provision. As the price of tobacco goes up in New Zealand it provides more incentive for people to use a provision such as this to access their tobacco.
2. Customs resources are used to determine whether gifts of tobacco are genuine or not and if found not to be genuine to collect the revenue due or dispose of the tobacco (if it is abandoned).
3. The only option identified, other than the status quo is removing tobacco from the gift exemption. Analysis by Customs has shown that the gift concession could be removed relatively quickly To make any change to the gift concession does not require change to primary legislation or to any of New Zealand’s international obligations.
4. If the gift concession was removed, there would likely be short to medium term resourcing implications for administration of either increased quantities of abandoned tobacco or the preparation of Private Importer Declarations (where duty is paid on import).
5. If the gift concession was removed there would unlikely be any noticeable effect on Crown revenue (as privately imported tobacco assessed as dutiable is generally abandoned to Customs).

### *The ‘home grown’ allowance*

1. In New Zealand individuals may manufacture, at their place or residence, up to 15 kilograms of home-grown tobacco per adult per year for personal use. This amount equates to between 50 and 100 cigarettes per person per day.
2. Concerns about the size of the allowance under this concession were raised by the 2010 Māori Affairs Committee inquiry into the tobacco industry.
3. There are no reliable estimates of the quantity of home grown tobacco currently being produced. Tobacco plants and seeds are readily available in New Zealand, but whether this translates into the widespread use of home grown as an alternative product is not clear as it can take some skill to make a palatable tobacco product from a home grown plant.
4. However, a reduction in the allowance to either 3kg or 5kg would be consistent with the Government’s goal to reduce smoking, whilst still allowing a sufficient personal allowance for most smokers.
5. A 3kg limit would be equivalent to between 10 and 20 cigarettes per person per day, and would be sufficient for the average smoker. A 5kg limit would equate to between 17 and 35 cigarettes per person per day, and should be sufficient to accommodate heavier smokers (over 95 per cent of smokers smoke less than 30 cigarettes per day). The average is about 10-12 per day. Either of these reductions would also remove the incentive to sell or gift home-grown tobacco to others.
6. Reducing the home-grown allowance would not have a material impact on Crown Revenue.

### Consultation

1. After a report by the Finance and Expenditure Committee that called for a substantial reduction in duty-free tobacco concession, the Ministry of Health wrote to duty-free stores and airport companies in October 2012 to engage them as parties who have an interest in the retail of duty-free tobacco, and to seek their views.
2. Discussions with duty-free retailers indicated that implementation of any changes to the international traveller duty-free allowance would be much smoother, and any unintended consequences on duty-free and airport businesses and investors greatly reduced, if they could have at least two financial years between decisions being made and implementation coming into force. This time would allow for retailers to adjust business models and rental agreements with airports.
3. The Ministry of Heath, Customs and The Treasury have jointly provided advice to Ministers on options for reducing New Zealand’s duty-free concessions.

### Conclusions and recommendations

1. Officials consider that changes to all three concessions are workable, and consistent with the Government’s broader objectives.
2. On balance aligning the incoming traveller’s duty-free allowance with that of Australia, removing the gifting allowance entirely and reducing the ‘home-grown’ allowance to 5kgs are the preferred options.

### Implementation

1. If any of the options were to be pursued, officials consider that an announcement in the 2014 Budget that the Government intends to reduce and/or remove duty free tobacco concessions would provide a timely signal to airport companies and retailers.
2. Officials recommend that the optimal time for implementation would be either March / April 2015 or March / April 2016. This would allow time to minimise the implementation risks noted below.
3. Should the Government wish to progress some or all of these initiatives earlier, officials consider that the earliest feasible implementation date for any changes to the traveller’s duty-free allowance would be November 2014. However, officials consider that early implementation of any changes to the traveller’s duty-free allowance would pose some risks. In particular:
* New Zealand Customs has signalled that there is likely to be an increased risk of disruption at airports, as they will be required to manage low levels of consumer awareness and increased border processing during the peak season
* discussions with duty-free retailers have suggested that two financial years between announcement and implementation would allow business models to adapt with minimal disruption
* New Zealand will need to address our international obligations with regard to three Customs instruments that refer to duty-free tobacco limits.
1. Changes to the gift and home-grown allowances could be made earlier, by August 2014. Changes to the home-grown allowance for an application date of either November 2014 or March/April 2015 would require legislation to be passed this year.

### *Public awareness and border processing*

1. Passengers are required to declare (on the passenger arrival card) whether or not they are carrying dutiable goods in excess of any concessions available. Where dutiable goods are declared, the passenger is required to pay the duty. If found to be in possession of undeclared dutiable goods, passengers may be prosecuted and the goods seized.
2. The experience from Australia when their tobacco concession was reduced in 2012 with little warning was that there was an initial period of 6-9 months when there was a substantial (600%) increase in the number of passengers needing additional processing for duty collection, or who abandoned tobacco products rather than pay the duty. Following this initial period, volumes have reduced from the peak, but are still higher than before the concession was reduced.
3. Extrapolating from the Australian experience, the New Zealand Customs Service estimates that if New Zealand reduces its concession the number of passengers who would require additional processing at airports would increase from 2,600 per annum currently to in the range of 6,500-14,000 per annum, and that the amount of tobacco abandoned at airports would increase from 2,400 cartons per annum to in the range of 9,500-20,000 cartons for the initial 6-9 month “bedding in” period.
4. To keep the increases on passenger processing and abandoned tobacco at the lower end of the projections above, any change to the duty-free allowance would require an awareness campaign to inform travellers of the new allowance level. Drawing from the Australian experience, the New Zealand Customs Service considers that this campaign should begin at least three months before the change and the implementation date should avoid the summer peak period to minimise the risk of disruption at airports. This suggests starting the awareness campaign in November/December, and implementing the new regime from the end of March or early April – well away from peak seasonal passenger volumes.
5. This level of awareness campaign will help to manage immediate impacts on processing of passengers at the border, as well as any potential costs associated with significantly increased seizure activity.

### *Commercial impacts on retailers*

1. As highlighted above, any meaningful reduction in the traveller’s duty-free allowance is likely to affect New Zealand duty-free retailers and airport companies. Following initial discussions, retailers have suggested that two financial years between announcement and implementation would allow business models to adapt with minimal disruption.

### *Financial impacts on Government revenue*

1. Removing or reducing the traveller’s duty-free allowance is expected to transfer some duty-free tobacco consumption into the excise, import tariff and GST bases. Accounting for the behavioural effects of a higher average price of smoking, the revenue forecasts from removing the traveller’s duty-free allowance entirely are:

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| --- | --- |
|  | **$m increase / (decrease)** |
| **Tax revenue** | **2014/15** | **2015/16** | **2017/18** | **2018/19 and out years** |
| November 2014 implementation | 35.000 | 50.000 | 50.000 | 50.000 |
| March/April 2015 implementation | 10.000 | 50.000 | 50.000 | 50.000 |
| March/April 2016 implementation | - | 10.000 | 50.000 | 50.000 |

1. Reducing the allowance (as opposed to removing it entirely) would be expected to result in marginally lower revenue increases.
2. Customs signalled that they would require operating funding of $2.34 million in the first full-year of implementation with an increase in baselines of $0.420 per annum in out years. This would cover the costs associated with a communications and public awareness campaign, the additional Customs officers required for border processing, and the increased costs associated with disposal of abandoned tobacco.

### *Gift allowance*

1. Analysis by New Zealand Customs indicates that the gift concession could be removed relatively quickly, and with relatively little administration or compliance. There may be a small increase in tobacco being abandoned at the International Mail Centre. However it is expected that any increase in administration or disposal costs could be accommodated within existing baselines.

### *Home-grown allowance*

1. The primary issues with making changes to the home-grown allowance relate to monitoring and enforcement. Considerations should be given to more robust measures for enforcement, such as a registration scheme for home manufacturers; and a review of when tobacco is considered to be ‘manufactured’, to eliminate some gaming that currently occurs at the margin.
2. Any change to the home-grown allowance would require a change to primary legislation, the Customs and Excise Act 2006, and so would require legislation to be passed this year for a November 2014 or a March/April 2015 implementation date.

### Monitoring, evaluation and review

1. The impacts of changes to concessions will be monitored by the Ministry of Health, the New Zealand Customs Service, and Treasury.
2. Key indicators that will be monitored include: the volume of passengers requiring intervention, changes in legal markets, levels of predicted government revenues and characteristics of detected offending.
1. Out bound travellers duty-free sales are not covered and are controlled by destination country. [↑](#footnote-ref-1)
2. Only information that was presented to Ministers prior to the Budget 2014 decisions has been used in the preparation of this Regulatory Impact Statement. [↑](#footnote-ref-2)