

Departmental Disclosure Statement

Customs and Excise (Tobacco Products) Amendment Bill
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The departmental disclosure statement for a government Bill seeks to bring together in one place a range of information to support and enhance the Parliamentary and public scrutiny of that Bill.

It identifies:

- the general policy intent of the Bill and other background policy material;
- some of the key quality assurance products and processes used to develop and test the content of the Bill;
- the presence of certain significant powers or features in the Bill that might be of particular Parliamentary or public interest and warrant an explanation.

This disclosure statement was prepared by the New Zealand Customs Service.

The New Zealand Customs Service (Customs) certifies that, to the best of its knowledge and understanding, the information provided is complete and accurate at the date of finalisation below.

17 May 2022.

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Part One: General Policy Statement

This Bill amends the Customs and Excise Act 2018 (the Act), and the Excise and Excise-equivalent Duties Table (the EEDT). The purpose of the Bill is to ensure that the correct excise and excise-equivalent duty is applied to certain tobacco goods and to reduce duty evasion.

To counter the difficulty of determining the actual tobacco content of water-pipe tobacco for the correct levying of excise and excise-equivalent duty (which creates opportunities for illicit trade), the Bill contains measures to combat suspected under-declaration of tobacco content by importers of water-pipe tobacco and to secure Crown revenue from taxes on water-pipe tobacco. It imposes import controls, changes the statistical unit for calculating duty, and creates a new excise and excise-equivalent duty rate for water-pipe tobacco, which is also known as flavoured tobacco, hookah, shisha, molasses tobacco, and fruit tobacco.

The Bill also amends the definition of tobacco product in Schedule 3 of the Act to include new tariff and excise headings as a result of changes made to the Harmonized Commodity Description and Coding System (the HS Code).

Permit required to water-pipe tobacco

The Bill imposes import controls in the form of making water-pipe tobacco a prohibited import by removing it from the list of tobacco products in section 95A of the Act to which prohibition does not apply. This brings water-pipe tobacco within the scope of the permitting regime in Schedule 3A of the Act. Tobacco products require a permit to import issued by the Chief Executive of the New Zealand Customs Service (Customs) before importation. Any water-pipe tobacco imported without a permit, or in breach of the conditions of a permit, would be subject to forfeiture (which is currently the case with smuggled water-pipe tobacco).

New statistical unit and duty rate

The Bill amends the EEDT to replace the current method of charging per kilogram of tobacco content for water-pipe tobacco with charging based on total weight. It also amends 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%.

These changes are necessary as Customs suspects some importers are drastically under-declaring the tobacco content of the product, evading much of the duty they should be paying. Not paying duty also undermines the health strategy of using tobacco taxation to reduce consumption. More honest importers are also competitively disadvantaged relative to dishonest importers.

Simplified seizure process and compensation for destruction of goods in error

Removing water-pipe tobacco from the list of goods in section 95A of the Act to which prohibition does not apply means that water-pipe tobacco will also be subject to the simplified seizure process under sections 185A and 185B of the Act, with importers able to seek compensation in accordance with Schedule 3B if water-pipe tobacco is disposed of incorrectly.

Transitional arrangement

The Bill amends Schedule 1 of the Act to provide for consignments to enter without import controls and at the pre-amendment rate of duty if the importer provides evidence that the goods were en route to New Zealand before the date on which the Bill takes effect.

Amendment to definition of tobacco product in Schedule 3 of Act

The Bill amends the definition of tobacco product in clause 21(6) of Schedule 3 of the Act to enable annual inflation adjustment to goods classified under new tariff heading 24.04 and the corresponding excise heading 99.67. This is a consequential amendment arising from changes to the New Zealand Tariff and the EEDT on 1 January 2022. The New Zealand Tariff is based on the HS Code, an international system that codifies all goods as a basis for tariff charging and for collecting international trade statistics. The HS Code is updated periodically to reflect changes in technology and trade patterns.

The 1 January 2022 HS Code revision required some tobacco products that had previously been classified under tariff headings 24.02 and 24.03 to be reclassified under new tariff heading 24.04. The reclassified products retained the same excise rate that applied previously. Both the New Zealand Tariff and the EEDT were amended to add new tariff heading 24.04 and the corresponding excise heading 99.67.

Clause 21(6) of Schedule 3 of the Act defines tobacco products for the purposes of the annual inflation adjustment by reference to tariff headings 24.02 and 24.03, and to the corresponding excise items 99.60 and 99.65. This means tobacco products classified under the new tariff heading 24.04 and the corresponding excise heading 99.67 cannot be adjusted annually for inflation without this amendment, and will become out of step with the excise rates for tobacco products under the other 2 headings.

Part Two: Background Material and Policy Information

Published reviews or evaluations

2.1. Are there any publicly available inquiry, review or evaluation reports that have informed, or are relevant to, the policy to be given effect by this Bill?	NO

Relevant international treaties

2.2. Does this Bill seek to give effect to New Zealand action in relation to an international treaty?	NO
<p>The amendment to the definition of “tobacco product” in Schedule 3 of the Act is as a result of a periodic review of the Harmonized Commodity Description and Coding System (HS Code) undertaken by the World Customs Organization (WCO). The (WCO) manages the HS Code. The HS Code is used by over 200 countries (including New Zealand) as a basis for tariff charging and for collecting international trade statistics. Every country that uses the HS Code must implement the updated version in their national tariff.</p>	

Regulatory impact analysis

2.3. Were any regulatory impact statements provided to inform the policy decisions that led to this Bill?	YES
<p>RIS: <i>Amending how excise and excise-equivalent duty is calculated, and making flavoured tobacco a prohibited import to stop tax evasion</i>: New Zealand Customs Service, 23 March 2022.</p> <p>The Regulatory Impact Statement will be published after Budget 2022 has been finalised, with any redactions that would be justified if the information had been requested under the Official Information Act 1982. They will be available at: https://www.customs.govt.nz/about-us/information-releases/cabinet-material/.</p> <p>A regulatory impact statement 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 New Zealand’s international obligations to the World Customs Organization”. 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.</p>	

2.3.1. If so, did the RIA Team in the Treasury provide an independent opinion on the quality of any of these regulatory impact statements?	NO
<p>The RIS did not meet the threshold for RIA Team assessment. The RIS was assessed by Customs’ RIA Panel and the information and analysis were judged as partially meeting the quality assurance criteria due to the data limitations and lack of consultation. The lack of consultation and the data limitations are fully acknowledged. The promised monitoring will help alleviate data limitations.</p>	

2.3.2. Are there aspects of the policy to be given effect by this Bill that were not addressed by, or that now vary materially from, the policy options analysed in these regulatory impact statements?	YES
<p>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 when 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]. It 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. 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.</p>	

Extent of impact analysis available

2.4. Has further impact analysis become available for any aspects of the policy to be given effect by this Bill?	NO
2.5. For the policy to be given effect by this Bill, is there analysis available on:	
(a) the size of the potential costs and benefits?	YES
(b) the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?	NO
<p><i>2.5 (a) New statistical unit and duty rate for water-pipe tobacco</i></p> <p>The analysis is set out in the Regulatory Impact Statement: <i>Amending how excise and excise-equivalent duty is calculated, and making flavoured tobacco a prohibited import to stop tax evasion</i>. Those who are importing these products with the intent of evading excise and excise-equivalent duty by under-declaring the tobacco content will have the potential to suffer a loss of income or wealth because of these policy changes. That is because they will now need to pay excise based on an assumed tobacco content of 15 percent.</p> <p>Water-pipe tobacco is particularly favoured by people with a Middle Eastern background. It is possible that paying the correct excise-equivalent duty will increase the retail price. Moreover, 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.</p> <p>Continued, see Appendix One.</p>	

2.6. For the policy to be given effect by this Bill, are the potential costs or benefits likely to be impacted by:	
(a) the level of effective compliance or non-compliance with applicable obligations or standards?	NO
(b) the nature and level of regulator effort put into encouraging or securing compliance?	NO

Part Three: Testing of Legislative Content

Consistency with New Zealand's international obligations

3.1. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with New Zealand's international obligations?
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As part of the policy development process, the proposed policy was looked at in relation to the World Health Organisation Framework Convention on Tobacco Control. It was determined that the proposed prohibition would be consistent with the principles of the World Health Organisation Framework Convention on Tobacco Control.

The Ministry of Foreign Affairs and Trade has been consulted to ensure the policy is consistent with New Zealand's international obligations.

Consistency with the government's Treaty of Waitangi obligations

3.2. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi?

The Bill is consistent with the principles of the Treaty of Waitangi as it targets those importers who under-declaring the tobacco content of water-pipe tobacco to evade excise duty. Maori have a higher smoking rate than the population generally. The availability of cheap water-pipe tobacco through under-declaring the tobacco content undermines public health measures to encourage smokers to quit through taxes raising the price of tobacco.

Consistency with the New Zealand Bill of Rights Act 1990

3.3. Has advice been provided to the Attorney-General on whether any provisions of this Bill appear to limit any of the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990?	YES
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The Bill has been vetted and advice was provided to the Attorney General on 5 May 2022, and will be available on the Ministry of Justice website when the Bill is introduced, see <https://www.justice.govt.nz/justice-sector-policy/constitutional-issues-and-human-rights/bill-of-rights-compliance-reports/advice/>.

Offences, penalties and court jurisdictions

3.4. Does this Bill create, amend, or remove:	
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(a) offences or penalties (including infringement offences or penalties and civil pecuniary penalty regimes)?	NO
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(b) the jurisdiction of a court or tribunal (including rights to judicial review or rights of appeal)?	NO
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However, the Bill links water-pipe tobacco into existing offences in the Act including (failure to comply with a term or condition of the permit is an offence under section 388 of the Act) (offences in relation to importation or exportation of prohibited goods) and section 389 (offences in relation to knowingly importing or exporting prohibited goods).

Schedule 3A (Permit to import tobacco and tobacco products) Clause 6 provides for "An applicant who is dissatisfied with a decision of the chief executive under this clause may, within 20 working days after the date on which the notice of the decision is given, appeal to a Customs Appeal Authority against that decision".

3.4.1. Was the Ministry of Justice consulted about these provisions?	NO
The Ministry of Justice was consulted on the Bill, not as part of the policy development, as the key changes are revenue related.	

Privacy issues

3.5. Does this Bill create, amend or remove any provisions relating to the collection, storage, access to, correction of, use or disclosure of personal information?	NO

External consultation

3.6. Has there been any external consultation on the policy to be given effect by this Bill, or on a draft of this Bill?	NO
<p>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 stockpile product ahead of any signalled changes in order to pay less excise-equivalent duty, as the product has a two year lifespan. Customs considers this limited consultation is appropriate in the circumstances.</p> <p>No consultation was undertaken to the change to the definition of “tobacco product” in Schedule 3 of the Act as it on the technical amendment, it will maintain the pre-1 January 2022 status quo.</p>	

Other testing of proposals

3.7. Have the policy details to be given effect by this Bill been otherwise tested or assessed in any way to ensure the Bill’s provisions are workable and complete?	YES
<p>All proposals in the Bill have been reviewed by internal operational subject matter experts under Customs standard process for assessing the feasibility of any new policy initiatives and ensuring they are workable and cost effective. This involves assessing whether systems need to be changed and, if so, whether formal testing needs to be carried out. None of the measures in the Bill have required formal testing.</p>	

Part Four: Significant Legislative Features

Compulsory acquisition of private property

4.1. Does this Bill contain any provisions that could result in the compulsory acquisition of private property?	NO

Charges in the nature of a tax

4.2. Does this Bill create or amend a power to impose a fee, levy or charge in the nature of a tax?	NO

Retrospective effect

4.3. Does this Bill affect rights, freedoms, or impose obligations, retrospectively?	NO

Strict liability or reversal of the usual burden of proof for offences

4.4. Does this Bill:	
(a) create or amend a strict or absolute liability offence?	NO
(b) reverse or modify the usual burden of proof for an offence or a civil pecuniary penalty proceeding?	NO
The Bill through making water-pipe tobacco a prohibited import requiring a permit to import, links water-pipe tobacco into existing offences in the Act including (failure to comply with a term or condition of the permit is an offence under section 388 of the Act) (offences in relation to importation or exportation of prohibited goods) and section 389 (offences in relation to knowingly importing or exporting prohibited goods).	

Civil or criminal immunity

4.5. Does this Bill create or amend a civil or criminal immunity for any person?	NO

Significant decision-making powers

4.6. Does this Bill create or amend a decision-making power to make a determination about a person's rights, obligations, or interests protected or recognised by law, and that could have a significant impact on those rights, obligations, or interests?	NO

Powers to make delegated legislation

4.7. Does this Bill create or amend a power to make delegated legislation that could amend an Act, define the meaning of a term in an Act, or grant an exemption from an Act or delegated legislation?	NO

4.8. Does this Bill create or amend any other powers to make delegated legislation?	NO

Any other unusual provisions or features

4.9. Does this Bill contain any provisions (other than those noted above) that are unusual or call for special comment?	NO

Appendix One: Further Information Relating to Part Two

Extent of impact analysis available – question 2.5(a)

New statistical unit and duty rate for water-pipe tobacco

Imports of water-pipe tobacco are generally from the United Arab Emirates, Jordan, Iran, Iraq, India, Europe, and the United States of America. Some importers are declaring KTC as low as 0.4 per cent and, others are declaring between two and five per cent. One overseas manufacturer of water-pipe tobacco has indicated to Customs that the actual tobacco content is around 15 per cent.

Customs currently has to rely on the import declaration and information provided by manufacturers when requested by Customs. It is not technically possible for 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.

Customs does not consider that some of these declarations are plausible, but, in the absence of a robust testing methodology being available, it is difficult to contest them, including in Court. Open-source checks have indicated water-pipe tobacco can have a 30 per cent tobacco content. It is not clear how widespread this is, and whether this is an upper level. Imported packages are almost never marked with the tobacco content.

In 2020 and 2021 combined, the New Zealand Customs Service (Customs) collected \$5 million in total duty and Goods and Services Tax (GST) on water-pipe tobacco. Customs estimates the loss to the Crown from evasion could be up to \$31.5 million, over the two years.

If no action is taken, Customs expects that importers will continue to self-declare water-pipe tobacco at what are suspected to be unreasonably low levels and will continue under-paying excise-equivalent duty to the Crown. Customs predicts significantly increased volumes of water-pipe tobacco being undeclared or mis-declared both when imported into New Zealand and re-exported to Australia will continue.

Some importers who may be correctly declaring the KTC of their goods are currently impacted by the under-declaration of water-pipe tobacco, as an uneven playing field has been created in the market, enabling dishonest importers to undercut on price, as they are not paying the correct amount of duty. The new duty rate applying to all imports of water-pipe tobacco will address this.

The new duty rate will also impact the increased volumes of water-pipe tobacco being mis-declared both when imported into New Zealand and re-exported from New Zealand, especially to Australia, where excise on water-pipe tobacco is calculated at 100 per cent tobacco content.

All due revenue will be collected, as the importer will no longer self declares the KTC to determine duty paid. The importer calculates their duty payable using \$234.77 per kg of the total weight of the product. If as part of an audit, Customs suspects the duty paid is not correct, then Customs can easily assess the correct duty by weighing the goods and calculating the excise-equivalent duty payable. This is a significant improvement against the status quo, where Customs, when carrying out an audit of imports, cannot determine whether the claimed KTC is accurate or not as there is no means to test the amount of tobacco content in water-pipe tobacco.

The new duty rate also reflects New Zealand's tobacco tax policy, providing for tobacco content of a product to be subject to excise and excise-equivalent duty. Customs understands the percentage of tobacco content in water-pipe tobacco may be between 15 and 25 per cent, based on information supplied by one manufacturer. It may also be more or less than this percentage but this cannot be verified. Excise-equivalent duty at 15 per cent is at the low end of this scale, but an increase on what all importers currently pay under the status quo. The highest self-declared KTC in 2021 is 14.3 per cent and the lowest 0.4 per cent. All importers will be treated consistently.

While imperfect, as the actual tobacco content of the product can vary, it will result in the duty collected on water-pipe tobacco more closely corresponding with the duty that should be collected if the tobacco content of the product were able to be verified. It will better align the

duty on water-pipe tobacco with New Zealand's tobacco policy settings compared to the status quo. There will be minimal cost to implement and administer as it can be implemented the same way Customs calculates excise-equivalent duty for other imports of tobacco products and only requires a small change to the existing import process.

Customs cannot determine whether there will be any material implications for Māori, children, seniors, disabled people, women, people who are gender diverse, Pacific peoples, veterans, and rural communities. Customs is aware use of this product is not widespread, and the quantities imported are comparatively small.

As it is a niche product consumed by a relatively small group, Customs would not expect the impact of this change to impact large numbers of people. This proposal will impact some ethnic communities. Water-pipe tobacco is particularly favoured by people with a Middle Eastern background. It is likely the retail price will increase. 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.

The impacts will be direct and on-going. There will be a direct increase in excise-equivalent duty payable on water-pipe tobacco imports for importers that declared a lower amount of tobacco in their products. Excise-equivalent and tariff duty paid on imports from 2020 and 2021 was \$4.082 million. If the same amount was imported following this change, Customs expects the approximate excise and excise-equivalent and tariff duty paid to be \$31.78 million.

Customs anticipate there will be a flow on effect of increased retail prices as a result of this change, which will impact consumers of water-pipe tobacco. The retail price of a 50-gram pack is approximately \$25, based on open-source checks. Based on the range of KTC declared on some imports, the current estimated excise and GST component on a pack could range from \$1.30 (at 4.53% KTC) to \$4.12 (at 14.3% KTC), GST inclusive. This option would increase the estimated excise component of a 50-gram pack to \$4.31, GST inclusive. Customs anticipates that there may also be an increase in smuggling of water-pipe tobacco products into New Zealand as a result of the change, but the extent is likely to be small. This occurred in Australia, when they began to calculate excise-equivalent duty on water-pipe tobacco at 100 per cent tobacco content.

There will be a marginal increased benefit to society by ensuring water-pipe tobacco is taxed according to its health risk and New Zealand's tobacco tax policy, all due revenue is collected, and the product is taxed fairly and consistently for all importers.

There is a countervailing risk that product with higher tobacco content may be imported instead of lower tobacco product to take advantage of the rate. Customs will monitor this to the extent technically possible to do, and should it become apparent that a behavioural response is occurring, further measures may be warranted. These might include an increase to the excise rate, to reflect a higher assumed percentage of tobacco, at a future date. There is a possibility that this type of product may become more popular following the broader product changes indicated in the Smokefree 2025 Action Plan. This is, however, very uncertain, given the way this product is used – consumers may or may not see this as a replacement for other forms of tobacco that may be more restricted.

Prohibited import

Making water-pipe tobacco a prohibited import will require importers to apply to Customs completing a permit application form in advance of importation. Including water-pipe tobacco in the permit regime ensures Customs is aware of the identity of importers of tobacco products before importation can take place and can perform due diligence to manage the risk of non-payment of excise prior to granting a permit.

Legitimate importers would not be unduly inconvenienced. They will be required to apply to Customs in writing in advance of importation by completing an application for a permit to import tobacco. It is a simple form containing applicant contact details, type of tobacco product(s) for import and the purpose for importing, for example personal or commercial. There is no fee for a permit. Of the 15 commercial importers, five are familiar with the permit regime as they hold a permit to import tobacco products.

Currently, Customs is obliged to consider the range of compliance and enforcement options when identifying mis-declared water-pipe tobacco. Once the goods are a prohibited import,

some importers may decide not to mis-declare their goods and risk losing them, choosing instead to apply for a permit and pay the duty.

Amendment to definition of tobacco product in Schedule 3 of the Act

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, and the corresponding excise items 99.60 or 99.65. This means tobacco products classified under the new tariff heading 24.04 and corresponding excise heading 99.67 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 Bill amends the definition of tobacco products to include new tariff heading 24.04 and the corresponding excise heading 99.67 to enable annual indexation on these goods to continue.