The Treasury

Budget 2014 Information Release

Release Document

July 2014

www.treasury.govt.nz/publications/informationreleases/budget/2014

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 6(a) - to prevent prejudice to the security or defence of New Zealand or the international relations of the government

[2] 6(c) - to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial

[3] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[4] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[5] 9(2)(ba)(i) - to prevent prejudice to the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied.

[6] 9(2)(d) - to avoid prejudice to the substantial economic interests of New Zealand

[7] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[8] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[9] 9(2)(h) - to maintain legal professional privilege

[10] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[11] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[12] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[13] Not in scope

[14] 6(e)(iv) - to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [3] appearing where information has been withheld in a release document refers to section 9(2)(a).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

MINISTRY OF HEALTH
MANATU HAUORA

NEW ZEALAND CUSTOMS SERVICE
TE MANA ĀRAI O AOTEAROA

THE TREASURY
Kaitohutohu Kaupapa Rawa

Joint Report: Options to Reduce New Zealand's Duty-Free Tobacco Concessions

Date:	27 March 2014	**Report No:**	T2014/544 20140426
		File Number:	SH-13-5

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Agree** to the recommendations **Refer** to the Ministers of Health and Foreign Affairs	Monday 31 March 2014
Associate Minister of Health (Hon Tariana Turia)	**Agree** to the recommendations	Monday 31 March 2014
Minister of Customs (Hon Maurice Williamson)	**Agree** to the recommendations	Monday 31 March 2014

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Hemant Passi	Analyst, Tax Strategy, Treasury	04 917 6305 (wk)	[3]	✓
Brendon Baker	Senior Advisor, Tobacco Control Programme, Ministry of Health	04 816 3930 (wk)		
Anna Cook	Policy Manager, New Zealand Customs Service	901 7576 (wk)		

Actions for the Minister of Finance's Office Staff (if required)

Forward this report to the Ministers of Health and Foreign Affairs Return the signed report to Treasury.

Enclosure: No

Joint Report: Options to Reduce New Zealand's Duty-Free Tobacco Concessions

Executive Summary

Background

There are three concessions which exempt tobacco from excise duty and GST in New Zealand. 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.

Domestic duty-free prices for cigarettes are currently between 50 to 66 percent of domestic retail prices, and this price differential is expected to grow with two further 10 percent increases in the rate of excise scheduled over the next two years. As a result, the duty-free tobacco concessions provide significantly cheaper avenues for smoking. This is increasingly at odds with the Government's measures to encourage a reduction in smoking through strong price signals (via the recent increases to the rate of tobacco excise), and the wider goal to make New Zealand smoke free by 2025.

Options

The Ministry of Health and the New Zealand Customs Service have a work stream underway to develop proposals for reducing or removing New Zealand's duty-free tobacco concessions. Amongst the options identified are:

- Reducing or removing the traveller's duty-free allowance

- Removing the gift allowance, and

- Reducing the home-grown allowance.

Officials consider that changes to all three concessions are workable, and consistent with the Government's broader policy objectives. However, any change to the traveller's allowance will involve non-trivial implementation issues, including maximising public awareness in advance of any changes, allowing duty-free and airport businesses time to adapt their business models, and managing our current commitments to duty-free allowances under international law.

Implementation

If Ministers wish to pursue any of these initiatives, officials consider that an announcement at Budget that the Government intends to reduce and/or remove duty free tobacco concessions would provide a timely signal to retailers.

However we 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 above.

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.

- [9]

Changes to the gift and home-grown allowances could be made earlier by August 2014. However 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.

Financial implications

Removing or reducing the traveller's duty-free allowance is expected to bring some tobacco consumption into the excise 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:

	$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

Reducing the allowance (as opposed to removing it entirely) would be expected to result in marginally lower revenue. Making changes to the gift and/or home-grown allowance are not expected to have a material impact on Crown revenue.

New Zealand Customs have also signalled that they would require operating funding of $2.34 million in the first full-year of implementation to run a consumer awareness campaign, and manage increased costs of disposal and border processing. Ongoing funding of $0.42 million per year will also be required to cope with an anticipated increase in the level of border processing. This will either be sought as part of the between-Budget contingency (2015 implementation) or as part of the Budget process (2014 implementation).

Recommended Action

We recommend that you:

a **indicate** whether you wish to announce firm policy decisions in Budget 2014 to reduce and/or remove the following duty-free tobacco concessions:

i. The travellers duty free allowance

Yes/no. Minister of Finance	*Yes/no.* Associate Minister of Health	*Yes/no.* Minister of Customs

ii. The gift allowance

Yes/no. Minister of Finance	*Yes/no.* Associate Minister of Health	*Yes/no.* Minister of Customs

iii. The "home-grown" allowance

Yes/no. Minister of Finance	*Yes/no.* Associate Minister of Health	*Yes/no.* Minister of Customs

b If yes to any of the above, **note** that officials will provide a further paper seeking specific decisions on the Budget package, including option design and the timeframe for implementation.

c If no to any of the above, **note** that officials will provide a further report in June, in line with existing work programmes.

Andrea Black **Principal Advisor, Tax Strategy, Treasury**	Paul Badco **National Programme Manager, Tobacco Control, Ministry of Health**	Michael Papesch **Group Manager, Policy, New Zealand Customs Service**

Hon Bill English **Minister of Finance**	Hon Tariana Turia **Associate Minister of Health**	Hon Maurice Williamson **Minister of Customs**

Joint Report: Options to Reduce New Zealand's Duty-Free Tobacco Concessions

Purpose of Report

1. This report provides advice on options to reduce or remove New Zealand's duty-free concessions. This is with the view to ensuring that these concessions remain compatible with the Government's recent measures to reduce smoking through strong price signals, and its wider goal to make New Zealand smoke free by 2025.

Background

2. The Government has carried out regular annual increases to tobacco excise and excise equivalent duties in Budget 2010 and Budget 2012. The cumulative effect of these increases will raise the rate of excise by roughly 95% for cigarettes and 120% for tobacco. As a result, the retail price for a mid-range packet of 20 cigarettes has increased from $12.60 to $18 since 2011.

3. However there remain 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.

4. Domestic duty-free prices for cigarettes are currently between 50 to 66 percent of domestic retail prices, and this price differential is expected to grow with two further 10 percent increases in the rate of tobacco excise scheduled over the next two years. As a result, the duty-free tobacco concessions provide cheaper avenues for smoking which are increasingly at odds with the Government's measures to curb tobacco consumption through price signals.

5. The Government signalled that it would investigate possible mechanisms for reducing duty-free tobacco allowances in response to the 2010 inquiry by the Maori Affairs Committee into the tobacco industry. Since then, the issue of duty-free allowances for tobacco has also been raised by the Finance and Expenditure Committee (during its consideration of the 2012 Customs and Excise Amendment Bill), and most recently by the 2013 Health Committee inquiry into child health outcomes.

Analysis and Options

The traveller's duty-free allowance

6. Under the status quo, 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.

7. There is no strong policy rationale for the status quo, other than the existence of international agreements that provide for duty-free allowances. However, as domestic retail prices for tobacco continue to rise – with two further 10 percent increases in the rate of excise scheduled over the next two years – the incentive to exploit the growing price differential between domestically purchased tobacco and duty-free will increase.

8. Several countries have already reduced or removed their duty-free allowances for international travellers. For example, Singapore removed its allowance entirely in 1991; Hong Kong reduced its allowance to 19 cigarettes in 2010 (allowing for an open packet but effectively stopping duty free sales); and EU member states have the option of reducing their allowance to 40 cigarettes for incoming travellers, whilst there is no allowance at all for travel within the EU. Most recently Australia reduced its duty-free allowance for international travellers from 250 cigarettes to 50 in September 2012.

9. Drawing from international experience, the Ministry of Health and the New Zealand Customs Service have been considering options to reduce or remove the traveller's duty-free allowance.

Reducing the duty-free allowance

10. Although a reduction in the allowance would still allow a residual amount of duty-free consumption, officials consider that any meaningful reduction (for example to 50 cigarettes or less) would largely remove the incentives for inbound travellers to stockpile duty-free. This option would also spare compliance costs for inbound travellers travelling with a small quantity of tobacco for personal consumption.

11. As suggested by international experience, there are several possible ways to implement a reduction. One possibility would be to align our allowance to Australia's, which is currently set at 50 cigarettes (or an equivalent amount of tobacco). This would allow for a consistent Trans-Tasman approach which could require less passenger education and compliance/enforcement activity in the longer term – given that nearly half of all inbound international passengers come from, or via, Australia.

12. Another possibility would be to implement an 'open-packet' allowance, whereby incoming passengers would be allowed to bring in one open packet of cigarettes (or an equivalent amount of tobacco) duty-free. Although international pack sizes vary, officials consider that the vast majority consumed in New Zealand are 30 or less. This quantity would therefore seem to achieve a sensible trade-off between reducing the duty-free allowance, and minimising compliance for inbound passengers and administration for New Zealand Customs.

Removing the duty-free allowance

13. 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 the 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.

14. Removing the allowance would be expected to have the greatest impact on duty-free retailers in New Zealand, as it would eliminate the *inbound* market for duty-free tobacco. We do not yet have a sense of the relative importance of the inbound market to the commercial operations of New Zealand retailers, however it is plausible that the overall market for duty-free tobacco is a significant source of earnings. We note however that under any of the options considered here, retailers would still be able to sell duty-free tobacco to *outbound* international passengers.

15. Another possible option would be to phase out the allowance more gradually by moving to the Australian model in 2015, with the view to removing it entirely by March/April 2016. The merit of this approach is that it would allow maximum time for retailers to adapt their business models. However, it would also likely require a longer public awareness campaign.

Implementation issues

16. There are a number of non-trivial implementation issues that would arise under any change to the traveller's duty-free allowance.

International conventions on customs procedures and tourism

17. New Zealand has acceded to three international agreements that include concession requirements for duty-free tobacco.[1] As these set out minimum concession amounts, any reduction in New Zealand's concession would require reservations to be entered to those agreements.

18. [9]

19.

20.

Public awareness and border processing

21. 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, New Zealand Customs considers that this campaign should begin at least three months before the change and encompass the summer peak period. This suggests starting the awareness campaign at the latest in November/December, and implementing the new regime from the end of March or early April – well away from peak seasonal passenger volumes.

---

[1] United Nations Touring Convention (Convention concerning Customs facilities for touring) [1954]; OECD Decision-recommendation of the Council on International Tourism Policy [1985]; World Customs Organization Revised Kyoto Convention (International Convention on the simplification and harmonization of customs procedures) [1999].

22. 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

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

Legislative process

24. Changes to the traveller's duty free allowance can be effected by Order in Council.

Financial implications

25. Removing or reducing the traveller's duty-free allowance is expected to bring some tobacco consumption into the excise 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:

	$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

26. Reducing the allowance (as opposed to removing it entirely) would be expected to result in marginally lower revenue.

27. New Zealand Customs have also 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.

28. This additional funding will either be sought as part of the between-Budget contingency (2015 implementation) or as part of the Budget process (2014 implementation).

The gift allowance

29. Under current legislation, gifts or presents sent from persons abroad to persons resident in New Zealand are free of duty and GST providing that they do not exceed $110 in total value. This allowance currently includes gifts of tobacco products.

30. Evidence from the International Mail Centre (IMC) suggests that less than 400 consignments a year are genuine gifts of tobacco that are exempt from duty and GST. It is thought that this number is so small because relatively few smokers are aware of this concession. However, as the price differential between domestically purchased tobacco and duty-free tobacco increases, we would expect more consumers to start taking advantage of this concession at the margin.

31. Officials consider that removing tobacco from the gift exemption is the only feasible alternative to the status quo, as any intermediate option would be outweighed by administration and compliance costs. Under this option, all tobacco consignments, whether or not they are declared as gifts, will be required to have duty and GST paid before they are released.

32. Removing the gift allowance would be consistent with the Government's wider policy of encouraging a reduction in smoking through strong price signals. However, we do not expect the removal of this allowance to have a material impact on Crown revenue.

33. New Zealand is a signatory to the World Customs Organization's Revised Kyoto Convention 1999. Removing tobacco products from the gift concession would bring New Zealand into line with best practice.

Implementation issues

34. 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 IMC. However it is expected that any increase in administration or disposal costs could be accommodated within existing baselines.

35. Amending the gift concession can be achieved by Order in Council, and would not contravene any of New Zealand's international obligations.

The 'home-grown' allowance

36. In New Zealand, individuals may manufacture up to 15kg of home-grown tobacco per adult per year for personal use, which equates to between 50 and 100 cigarettes per person per day.

37. Concerns about the size of the allowance under this concession were raised by the 2010 Maori Affairs Committee into the tobacco industry. At the time, the Government agreed to consider the case for reducing the allowance, taking into account how this might be effectively monitored and enforced.

38. Officials consider that reducing the home-grown 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.

39. 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 roughly 17 to 35 cigarettes per person per day, and should be sufficient to accommodate most heavier smokers. Officials consider that either of these reductions would also remove the incentive to sell or gift home-grown tobacco to others.

40. While reducing the home-grown allowance is not expected to have a material impact on Crown Revenue, officials' view is that reducing or eliminating the concession has merit as it would be consistent with the Government's policy objectives.

Implementation issues

41. The primary issues with making changes to the home-grown allowance relate to monitoring and enforcement. Officials suggest considering 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.

42. Any change to the home-grown allowance would require a change to primary legislation, and so would require legislation to be passed this year for a November 2014 or a March/April 2015 implementation date.

Risks

43. [9]

44. New Zealand Customs also considers that implementation in November 2014 would put significant pressure on the efficient processing of passengers over the busiest part of the year. If Ministers do wish to implement policy change earlier further work will be required to provide advice on how this might best be achieved in a way that continues to provide for efficient passenger processing on the part of border agencies.

45. Officials consider that these risks, and other possible implementation risks around the commercial impacts on retailers, would be minimised by targeting a later implementation date of March/April 2015 at the earliest.

Next Steps

46. Should Ministers wish to progress any of these initiatives, officials consider that the Government could announce that it intends to reduce and/or remove the duty-free tobacco concessions in Budget 2014. An early announcement would also provide a signal to retailers to begin adjusting their business models.

47. If Ministers do indicate that they wish to announce changes in Budget 2014, officials will report back shortly seeking specific decisions, including on option design and implementation timeframes.

48. For any matters not included in the Budget, officials will report back in June on possible approaches, in line with existing work programmes. Note, however, that if provisions on home grown tobacco are not included in Budget night legislation, it is likely that this concession will not be able to be amended or removed before 2016.