Analysis of the Australian Alcohol Import / Export Market

Released by Department of Home Affairs
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Department of Home Affairs

30 June 2019
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Executive summary

Australia has a dynamic alcohol market with players that utilise a variety of supply chains. However, some of the import and re-export practices may pose threats to Australia's border revenue system.

Key characteristics of the Australian alcohol market

- The World Health Organization (WHO) estimate of the unrecorded alcohol market in Australia is 7.5 per cent of total per capita alcohol consumption;
- Spirits and ready-to-drink (RTD) products constitute s47E(d) of all imported alcohol by value;
- In 2018, s47E(d) million of Australia's alcohol exports were reported as goods of foreign origin for re-export (s 4 per cent of Australia's alcohol imports by customs value); and
- 47E(d)

Recommendations to support Australia's border revenue system

- A detailed estimate of the size and composition of the illicit alcohol market should be undertaken;
- The Department may wish to tailor its compliance activities towards areas of the market that are experiencing the most growth or competitive pressure;
- The *Effective Tax per Standard Drink Methodology* can potentially be deployed to identify priority areas of revenue risk;
- 47E(d)
- 47E(d)
- 47E(d)
- 47E(d)
- One option would be to develop a *Margin Analysis Methodology* to enable risk identification priorities for differing categories.

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Scope & Background

KPMG was engaged by the Department of Home Affairs (The Department) to analyse the size and nature of the domestic market of imported/exported alcohol products and support the Department in the identification of risks/threats in existing supply chain practices.

To deliver on this objective, in the constrained time period of four weeks, KPMG developed this short analytic report which measures and assesses the size and nature of the domestic market of imported alcohol products, and the size and nature of the market for export/re-export. The report also provides an assessment of the nature of the supply chain facilitating both import and export, including general business practices governing the movement of imported alcohol within Australia.

The analysis contained herein could be refined with additional analysis of the Department's Integrated Cargo System (ICS) data, or through consultations with the alcohol industry to further investigate suspicious supply chain practices and known instances of duty avoidance.

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1. The Australian Alcohol Market

1.1 Overview of the recorded market

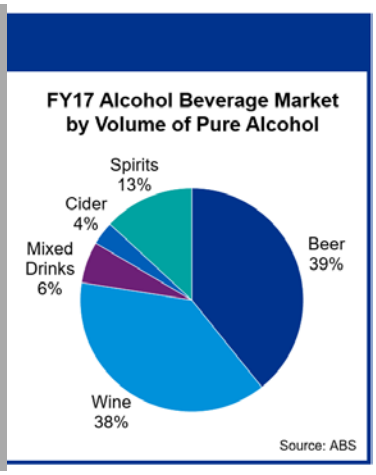
s47, s47E(d) [redacted]

In calendar year 2018, the total final retail size of Australia's recorded alcohol market was estimated at s47, s47E(d) [redacted] approximately 190 million litres of pure alcohol.[2]

As shown in Figure 1 below, the Australian alcohol market is dominated by beer in both volume and value terms. s47, s47E(d) [redacted]. Beer was also, very narrowly over wine, the leading category by volume of pure alcohol in 2016-17. However, this is not the case if we only look at the composition of the imported market (see Figure 2, overleaf).

Figure 1. Australian Recorded Alcohol Market

s47, s47E(d) [redacted]



s47G [redacted]

1.2 The Illicit Market

In 2016, unrecorded alcohol consumption was estimated by the WHO to constitute 7.5 per cent of total consumption on a per capita basis, down from 14.4 per cent in 2010.[4] If this illicit market estimate is accurate, the total s47, s47E(d) [redacted] alcohol market may be closer s47, s47E(d) [redacted] 205 million litres of pure alcohol. Indeed, assuming there is uniform unrecorded consumption across the different categories, this could suggest that there may have been approximately s47, s47E(d) [redacted] million in foregone excise duties, excise equivalent customs duties and WET during financial year 2018-2019.[5]

However, there are significant challenges to verify these estimates from available data sources. Industry intelligence might provide insights to identify which specific categories are more likely to contribute to the illicit, non-tax paid market. It would also be helpful to identify the possible changes in

s [redacted]

[2] ABS, 2018, *Apparent Consumption of Alcohol, Australia, 2016-17*, 4307.0.55.001; and IBISWorld, 2018, *IBISWorld Business Environment Profile: Total alcohol consumption*.
[3] RTDs are sometimes referred to as 'mixed drinks' in global data sets.
[4] WHO, 2018, Global status report on alcohol and health, p.312.
[5] Based on estimates in the Budget 2019-20: Budget Strategy and Outlook, Budget Paper No. 1, Statement 9: Australian Government Budget Financial Statement, Note 3: Taxation revenue by type.

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policy, business practices, compliance activities and other measures which may have contributed to the sizeable reduction, in six years, in the WHO estimate of unrecorded alcohol consumption.

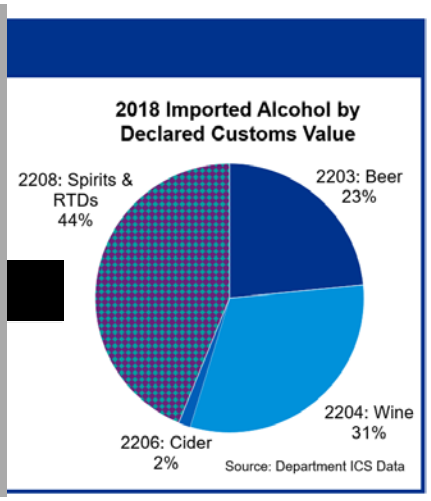
Recommendation: A detailed estimate of the size and composition of the illicit alcohol market should be undertaken.

1.3 The Import Market

s47, s47E(d) pirits and RTDs s47, s47E(d) generally face some of the highest effective taxation rates (see discussion below).

Figure 2. Australian Recorded Alcohol Import Market

s47, s47E(d)



s47, s47E(d)

s47, s47E(d) Importantly, declared customs values do not include the ad valorem customs duty (import tariff), excise equivalent customs duty, Wine Equalisation Tax (WET), GST or profit margins s47, s47E(d).

Figure 3 visualises the customs value and excise / WET liability declared at the time of an N10 or N30 declaration in 2018, for the three, most common four-digit Harmonised System (HS) alcohol category codes. It also shows that spirits & RTDs (combined) are the only category where the total tax burden is greater than the total landed value of the category.

s47E(d)

s

[4] Department ICS import data (2018).

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s47, s47E(d)

s47, s47E(d)

s47, s47E(d)

The five top countries of origin for imported alcohol in 2018 are depicted in Table 1 as classified by s47, s47E(d) customs value. French products, mostly sparkling and still wines, are the most imported by customs value s47, s47E(d)

Table 1. Top countries of origin for alcohol imported into Australia (2018)

Rank	By Customs Value	s47, s47E(d)
1	France	
2	New Zealand	
3	United Kingdom	
4	United States	
5	Mexico	

s47, s47E(d)

1.4 The Export Market

s47, s47E(d)

s47, s47E(d)

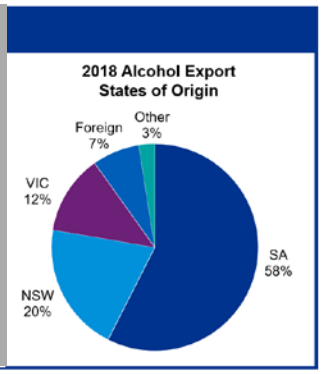
s47, s47E(d)

s47, s47E(d)

s47, s47E(d)

Figure 4. Australian Export Market (2018)

s47, s47E(d)



[9] Department ICS import data (2018).

[11] Department ICS export data (2018).

[13] Ibid.

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In 2018, Australia's alcohol exports predominately originated from South Australia, with New South Wales and Victoria being the only other significant alcohol exporting states.

1.5 The Re-export Market

s47, s47E(d) KPMG understands that goods can only be reported as such if they did not enter into Australia's excise regime (i.e. if they are not subject to processing or substantive transformation and are not blended/bottled under bond).[15]

See further detailed analysis in section 3.4.

1.6 Consumption Trends

s47, s47E(d)

Recommendation: The Department may wish to tailor its compliance activities towards areas of the market that are experiencing the most growth or competitive pressure.

s47, s47E(d)

[14] Department ICS export data (2018).
[15] See ABS, 2006, Australian Harmonized Export Commodity Classification (AHECC), 1233.0 "YY-FO", accessed 26 June 2019 at https://www.abs.gov.au/AUSSTATS/abs@.nsf/66f306f503e529a5ca25697e0017661f/87cc57f9c6ded15eca256b21000001af!OpenDocument, and Australian Customs Notice No. 3003/70, State of origin for exports access 26 June 2019 at: https://www.abf.gov.au/help-and-support-subsite/CustomsNotices/2003-70.pdf.
[17] Ibid.

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2. Alcohol taxation frameworks and effective taxation methodology

2.1 Alcohol taxation legislative frameworks

There are significant differences in the alcohol taxation legislative frameworks that apply to imported alcohol. The WET operates in a very different way to the excise equivalent customs duty which mirrors the excise taxation system. A summary and graphical representation of the interaction of these complex alcohol taxation legislative frameworks is set out in *Attachment A*.

The complex interaction between the WET and the excise equivalent duties creates opportunities to avoid and reduce taxation liabilities. A deep understanding of the interaction of the definitional structures within these complementary alcohol taxation frameworks is essential to identifying key revenue risks. For example, a flavoured cider is actually an RTD, for excise purposes.

In the longer term, efforts to simply Australia's taxation frameworks, following best practice alcohol taxation policy, could help reduce the opportunities for nefarious players to leverage the complexity for their avoidance activities. Indeed, a common volumetric tax on alcohol could remove many of the incentives driving these behaviours.[18]

2.2 *Effective taxation rate methodology* as a risk identification tool

The industry has developed, over many years, a bespoke methodology to accurately compare the incidence of alcohol taxation across differing taxation legislative frameworks. This methodology can be summarised in the concept of *effective taxation rates per standard drink*.

The methodology has been refined to allow a meaningful comparison of differing taxation regimes, on a per standard drink basis (12.67 grams of alcohol). This methodology can be deployed to identify the higher risk categories for scrutiny.

It is a little known fact that higher priced imported wine (and sparkling wines) pay a higher effective tax rate, on a per standard drink basis, than spirits, see Figure 5 overleaf.

Spirits, RTDs (including flavoured ciders) and high value wine products are likely to be the preferred focus for enforcement activities, as there is a greater incentive for importers to improperly minimise or avoid their duty/WET obligations in relation to these categories.

In particular, this methodology highlights the differing effective rates for traditional cider (which is subject to the WET) compared with flavoured cider (which is subject to excise equivalent duty). This significant differential creates a major potential revenue risk, if the incorrect classification is provided upon importation.

Recommendation: The *Effective Tax per Standard Drink Methodology* can potentially be deployed to identify priority areas of revenue risk.

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[18] See discussion in Henry, Ken, et al. "Australia's future tax system." *Canberra, Commonwealth Treasury* (2009).

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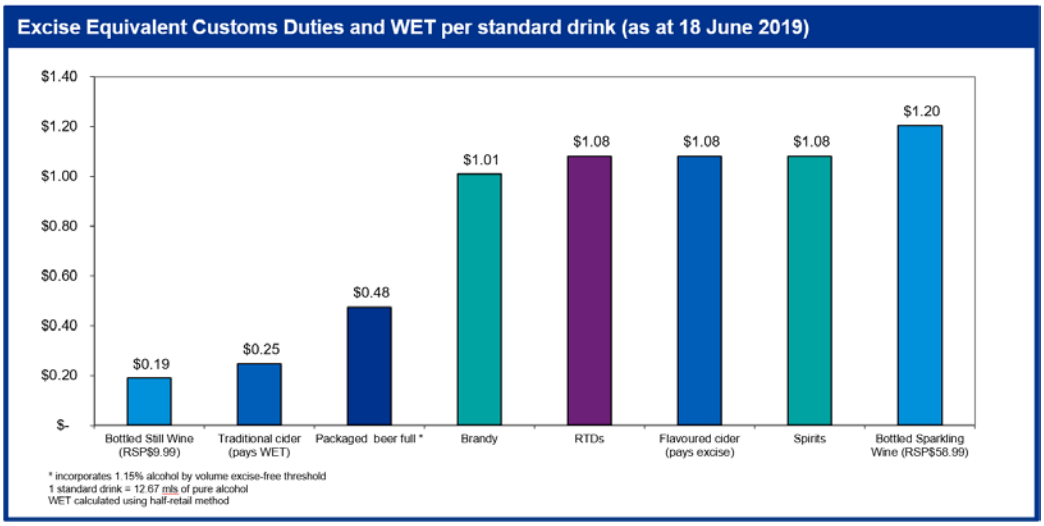
Figure 5. Excise Equivalent Customs Duties and WET per standard drink by category



The Tax Effective Tax per Standard Drink methodology can be refined to focus on more detailed product categories.

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3. Business Practices & Tax Revenue Leakage

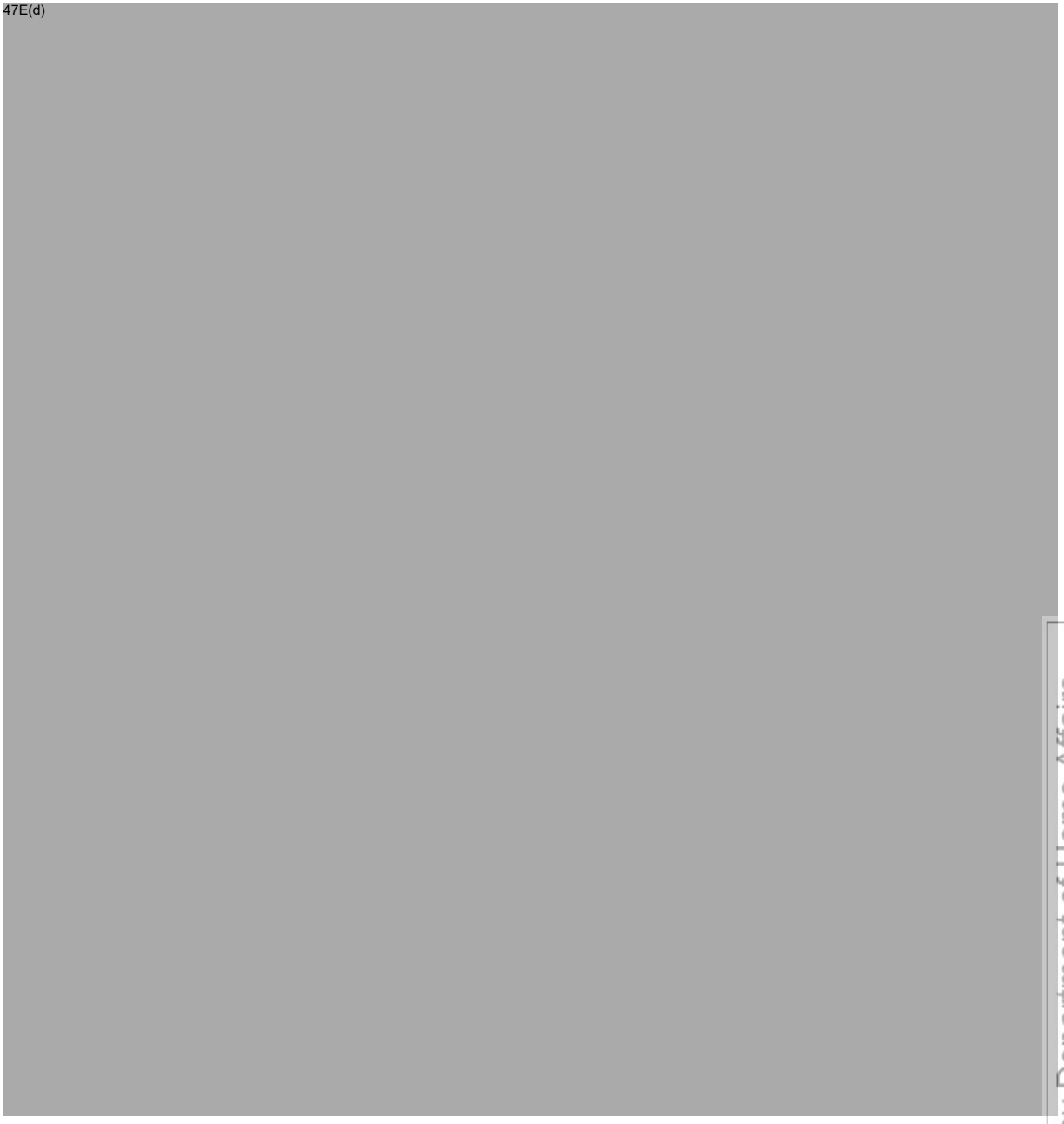
3.1 Import and Re-export Alcohol Supply Chains

There are several possible end-to-end supply chains for the import and re-export of alcohol products into Australia. Specific steps in the process, as they apply to different products, and potential areas for revenue leakage are numbered in a flow chart graphic set out in *Attachment B*. This includes detailed descriptions of the steps in the supply chains.

3.2 Business practices

There are a number of existing business practices in the imported alcohol market that are likely to lead to revenue leakage. A number of these practices are summarised in Table 2 below. These practices have been developed to manipulate steps in the alcohol supply chain depicted in *Attachment B*.

47E(d)



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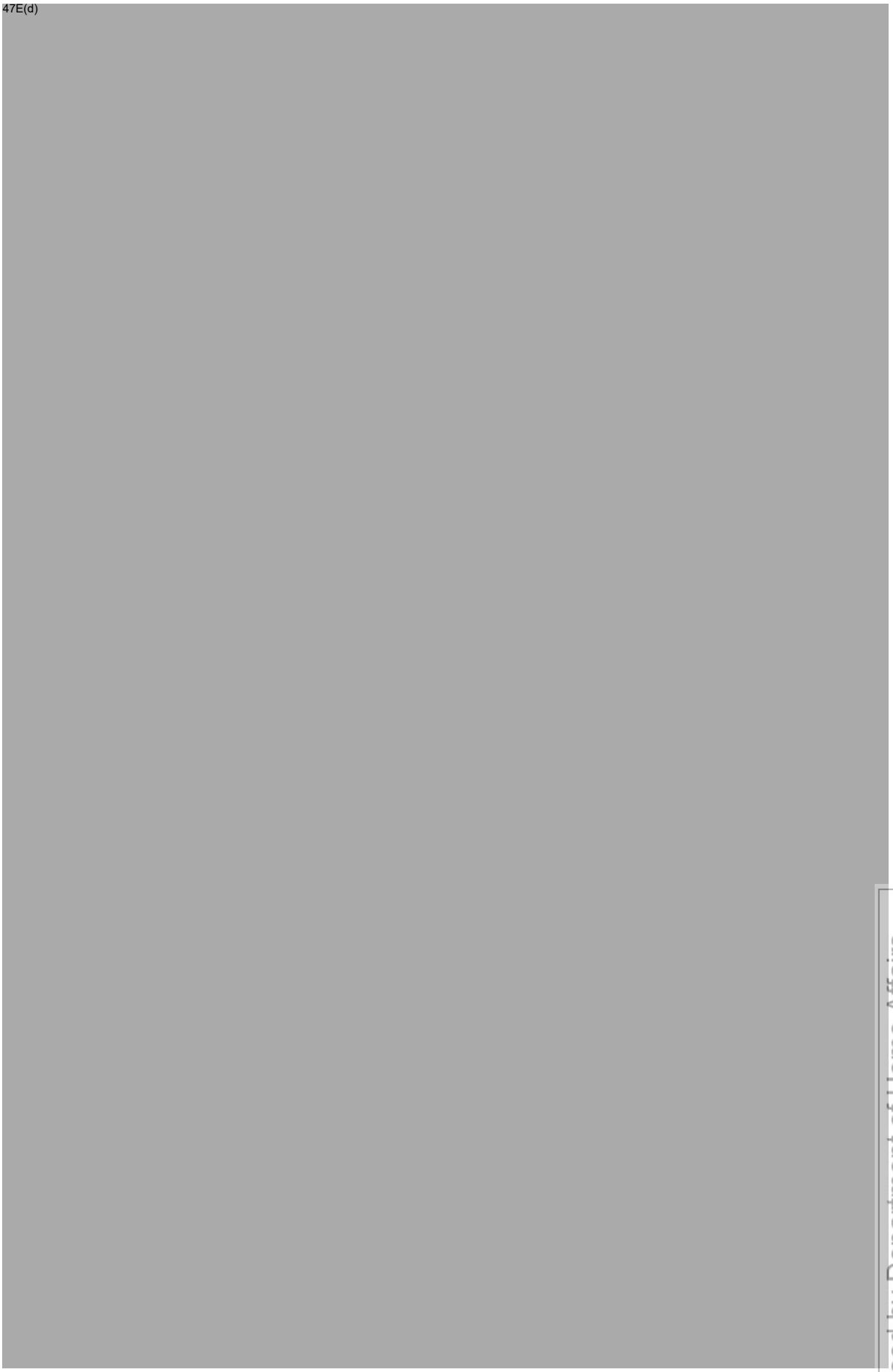

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47E(d)

3.3 Re-exported alcohol and revenue risks

It is not known what percentage of re-exported alcohol is at risk of diversion into the domestic market. One 2001 government estimate indicated that up to 30 per cent of re-exported alcohol was at such a risk.[19]

The analysis below highlights that some significant percentage of the 47E(d) of alcohol re-exports (see section 1.5) may continue to present such a risk. Some key insights are set out below.

47E(d)

The composition of the re-exported alcohol (see section 1.5) included:

- 47E(d) per cent whisky;
- 47E(d) per cent wine;
- 47E(d) per cent brandy; and
- 47 per cent vodka.

47E(d)

[19] See the Explanatory Memorandum to the *Customs Legislation Amendment And Repeal (International Trade Modernisation) Bill 2001.*

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Most of the re-exports are exported to countries in the Asia-Pacific region, such a 47E(d)

47E(d)

A further 47E(d) of alcohol re-exports were exported without having their destination declared.
47E(d)

47E(d)

47E(d)

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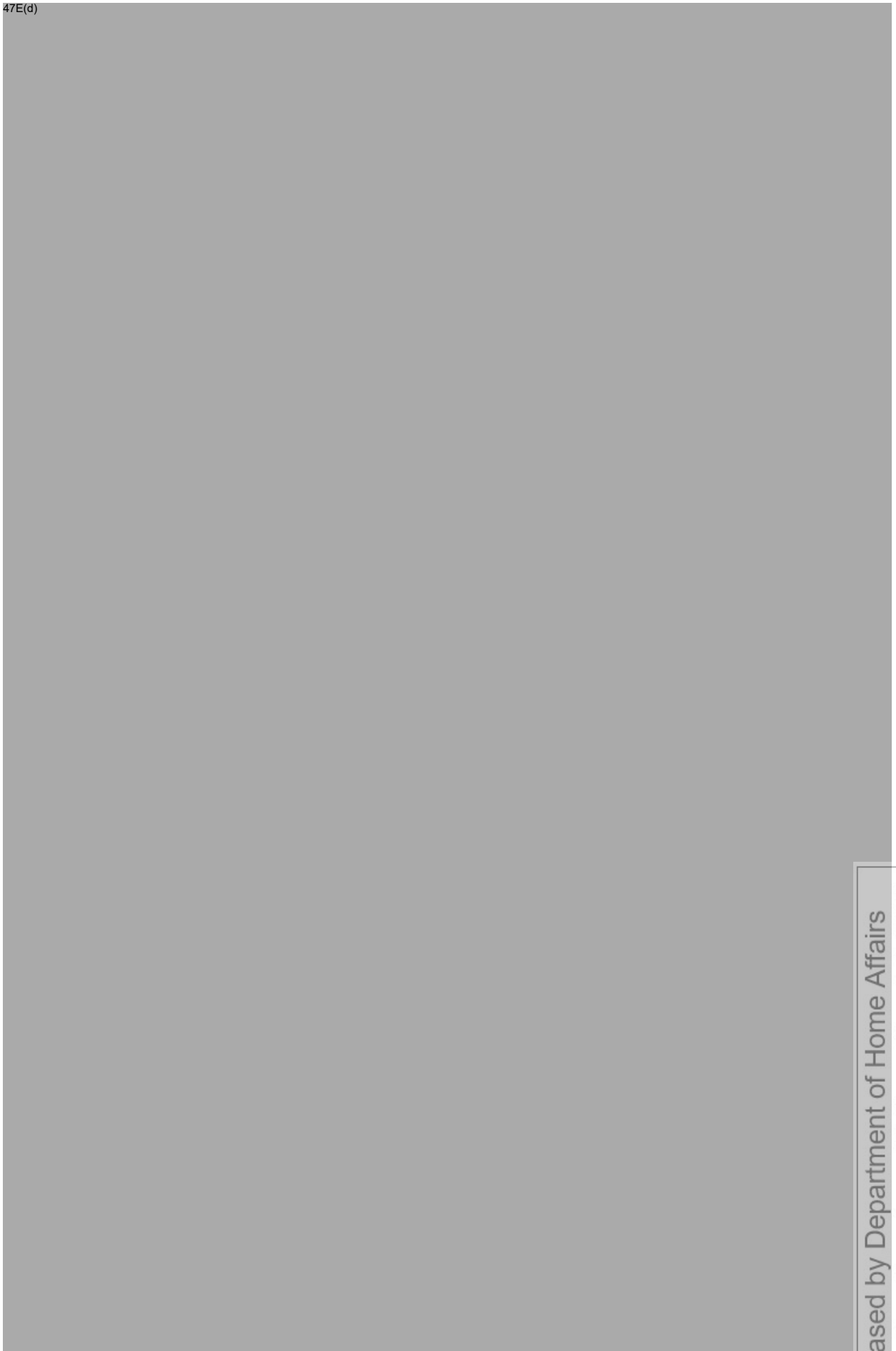
47E(d)



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47E(d)

These priority issues are not dissimilar to suspicious practices identified by industry as long ago as 2001. Industry evidence presented to a Senate Legal and Constitutional Legislation Committee identified similar business practices which comprise major revenue risks.[20] See *Attachment D* for extracts from the Senate Committee report which include the industry evidence which has similarities to the findings in this KPMG report.

3.6 Average margin methodology – case study

The following case study highlights potential priority revenue leakage issues at the Australian border. This has been selected to draw the Department's attention to generally applicable indicators of possible misconduct and to inform a potential risk framework for the identification of tax revenue leakage.

47E(d), 47G

The Department could undertake a project to develop and refine average margins of reputable industry players across differing categories.This would then enable the Department to undertake comparisons of low price operator margins against those reputable industry average margins. Industry experience shows that very small margins, on an ongoing basis, are often indicators of revenue leakage.

[20] See the Senate Legal and Constitutional Legislation Committee report (May 2001) into its Inquiry into the *Customs Legislation Amendment and Repeal (International Trade Modernisation) Bill 2001, Import Processing Charges Bill 2000*, and the *Customs Depot Licensing Charges Amendment Bill 2000.*

[21] Department Alcohol Imports Data.

[22] Prices points include GST.

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3.7 Conclusion: Potential Areas for Future Analysis

This report has included specific recommendations for priority actions. In addition, to fully understand the prevalence of malicious alcohol importation practices and the impact they might be having on Australia's tax revenue, the Department may also wish to:

- Investigate the complexity around the processes, and calculation of customs duty liabilities and duty drawback amounts, when imported goods are involved in manufacturing processes under bond for re-export or for domestic consumption. For example, if imported whisky is blended with domestic alcohol under excise bond and then re-exported, how exactly are the tax liabilities and potential duty drawback payments calculated to reflect the portion of the product that was an import;
- Investigate the overlap between exported alcohol goods marked of foreign origin in export declarations and alcohol exports on which a duty drawback is claimed;
- Examine the amount of WET being deferred through the ABN quotation process and, for those that pay WET at the time of importation, the method under which the WET liability is calculated.
- Undertake a detailed analysis of the complexity of Australia's alcohol taxation system and the potential discrepancies between tariff alcohol product classification (HS system) and excise alcohol product classification.

47, 47E(d) [redacted]

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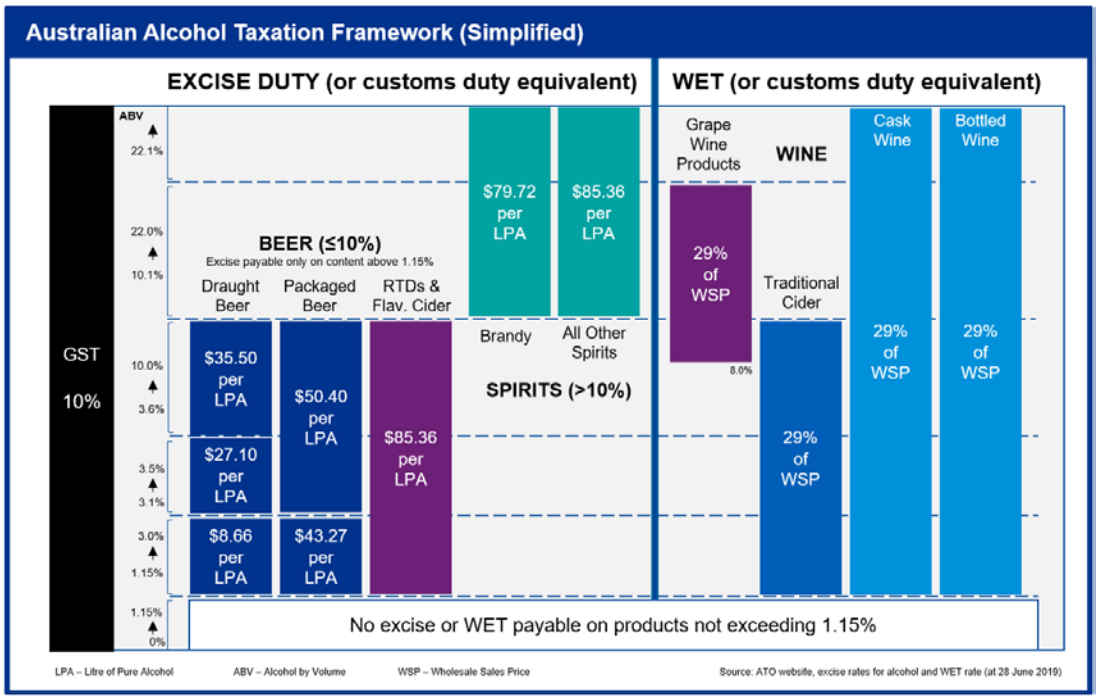
A. The Alcohol Taxation Legislative Frameworks

The Australian taxation framework for alcohol is complex and, as Figure A1 below demonstrates, there is significant differences in treatment depending on the classification of the product in question.

Figure A1. Alcohol taxation framework



Most notably, wine is taxed on the value of the product under the WET regime (*ad valorem* taxation) while all other types of alcohol pay excise based on the amount of pure alcohol in the beverage (volumetric taxation). No product with under 1.15 per cent alcohol by volume (abv) is subject to WET or excise, while only beer products are able to discount the first 1.15 per cent alcohol by volume in their product when calculating their excise liability. There are also a number of tax rate brackets for different types of beer - based on alcohol strength and whether it is a draught or packaged beer.

Definitional / classification challenges

In some cases, it can be difficult to determine if a product is subject to excise or WET. This is particularly true for mixed products with the characteristics of RTDs, wine products or ciders, which often straddle the various legislative definitions. Indeed, many of these products will be specifically engineered to obscure the definitional boundaries between the excise and WET regimes, to ensure that they are subject to the lowest effective taxation rate possible.

The WET system applies to wine which is defined to include grape wine, grape wine products, fruit or vegetable wine, cider or perry, mead and sake. The excise regime, on the other hand, applies to beer, brandy and other excisable beverages. Each of these terms have defined characteristics, with the exception of 'other excisable beverages' which captures alcohol products that do not meet the explicit definitions of a beer, brandy or wine. As a result, products on the boundaries of precise legislative definitions can very easily formulated to appear to be covered by differing taxation regimes.

Illustratively, a $30.00 bottle of plum wine liqueur (500ml) with 23 per cent abv would be classified as "other excisable beverage" and pay $9.82 of excise. However, if the manufacturer were to reduce the product's abv to 22 per cent (or just claim they had), the product would instead be classified as a fruit wine and pay only $8.70 of WET. Category definitions are also important in the context of the 'most favoured nation' 5 per cent *ad valorem* customs duty, which is only applied to some HS code tariff lines when there is no preferential rate. 47E(d)

[23] The Department ICS data.

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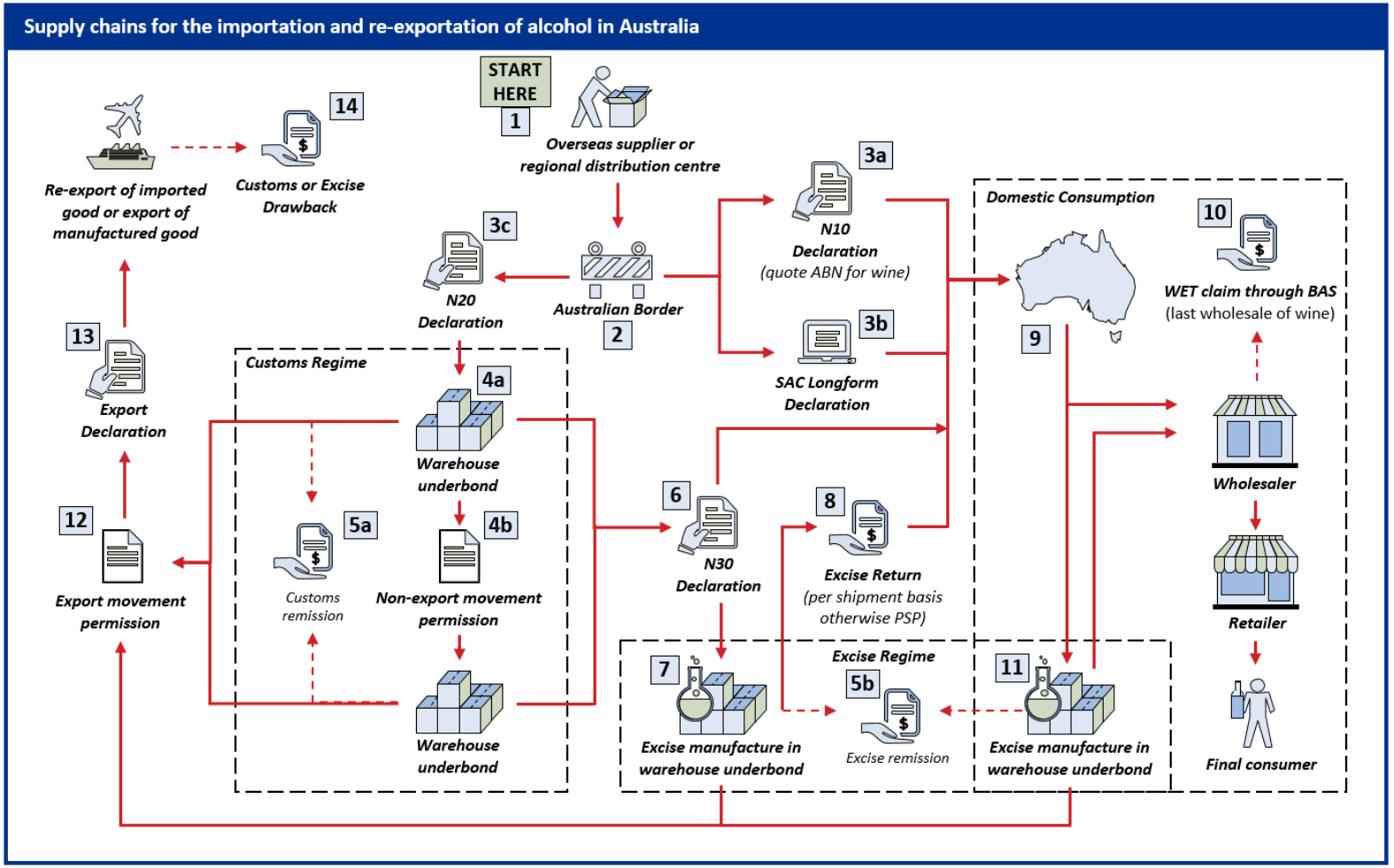
B. The Alcohol Supply Chain

The following graphic demonstrates the possible end-to-end supply chains for the import and re-export of alcohol products into Australia. Specific steps in the process are numbered in the graphic and described in the following table.

Figure B1. Alcohol supply chains which cross the border



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Steps in the Alcohol Supply Chain

The following table expands on the specific steps identified in the above alcohol supply chain graphic.

Table B1. Alcohol supply chain steps explained

Ref	Alcohol Supply Chain Steps
1	**Overseas supplier or regional distribution centre** Alcohol goods are acquired from an overseas supplier for import into Australia. The goods might come directly from the country of the international supplier, or pass through a regional hub (e.g. Singapore). Some companies use regional hubs to distribute their product while others might also transform or bottle their product in the hub. The use of regional hubs can effect country of origin claims with implications for preferential *ad valorem* customs duty treatment if the goods undergo 'substantial transformation'.
2	**Arrival in Australia** The imported alcohol goods arrive at the Australian border, are unloaded from the vessel/aircraft, and are immediately subject to customs control.
3a	**Import Declaration (N10 Form)** Importers lodge a Nature 10 for their alcohol goods to be cleared immediately into home consumption. When completing the document importers must declare the tariff classification, country of origin, customs value (derived from different valuation elements) and a description of the goods (quantity, units, alcohol strength etc.). At the time of preparation and lodgement of the Nature 10, the ad valorem customs duties, excise equivalent customs duties and GST amounts payable to Customs are calculated for payment prior to release of the goods. While WET is payable on imported wine at the time it is imported, many importers are able to quote their ABN in their declaration and defer the WET to a later stage in the distribution process.
3b	**Import Declaration (Self-Assessed Clearance)** Importers of alcohol goods valued up to $1,000 can also choose to complete a Longform Self-Assessed Clearance Declaration to have their goods released from Customs Control into domestic consumption (duties and GST will still be payable).
3c	**Import Declaration (N20 Form)** Importers intending to warehouse their imported alcohol goods in a customs licensed warehouse before clearing them from customs control are required to lodge a Warehouse Declaration (Nature 20).
4a	**Warehouse underbond** Goods entered on a Warehouse Declaration may be held indefinitely at a warehouse without payment of the ad valorem customs duty, excise equivalent customs duty or GST, until the goods are entered into domestic consumption, moved into the excise regime for manufacture or exported. Warehoused goods require permission to be moved.
4b	**Non-export movement permission** A non-export movement permission is needed to move the bonded goods from one licensed warehouse to another (e.g. another party's warehouse).

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Ref	Alcohol Supply Chain Steps
5a	**Customs Remission** If excise equivalent goods will not be delivered into domestic consumption, remissions (waivers) of the ad valorem and excise equivalent customs duty liability can be claimed via NAT 73478. This will occur in situations where there has been a change in the nature of the product. It might be that they have been, or will be destroyed, that they are no longer fit for human consumption, or they have deteriorated or been damaged (e.g. product evaporation).
5b	**Excise Remission** Once in the excise regime, only remissions (waivers) of the excise duty can be claimed. Claims are still made via NAT 4289 for alcohol goods that will not be delivered into home consumption due to a change in their nature.
6	**Import Declaration out of Warehouse (N30 Form)** An Import Declaration out of Warehouse (Nature 30) must be lodged in order to: • deliver the customs warehoused goods into home consumption – this requires the payment of customs/excise equivalent duty liability before delivery into home consumption, alternatively, payment is made via a weekly N30; or • report the movement of imported excise equivalent goods to the excise regime for the manufacture of excisable goods in a dual licensed customs and excise warehouse (using treatment code 444) – the ad valorem customs duty and import GST are payable at this point, and transfers the excise equivalent customs duty to the excise regime (for later payment).
7	**Manufacture underbond (outside domestic consumption)** Imported alcohol goods are transformed in a dual licensed customs and excise warehouse whilst still being held underbond. Most commonly, high strength bulk spirits (usually at 80% abv approximately) are imported for the purpose of (a) blending into RTDs or (b) diluting/'breaking down' into full strength spirits at 40% abv or less. Breaking down constitutes excise production for excise purposes.[24] The resulting products can then be re-exported or enter into domestic consumption.
8	**Excise Return** Alcohol goods that are transformed in a dual licensed customs and excise warehouse for importation are required to pay their excise liability before entering domestic consumption. This can be done on a per shipment basis through form NAT 4285 or, alternatively, through a periodic settlement permission (PSP) which is usually settled weekly.
9	**Goods Enter Domestic Consumption** Once goods have cleared customs they enter into domestic consumption and can then follow standard wholesale/retail business supply chains to end up in the hands of consumers. Alternatively, the imported products that have been entered for home consumption can still be used for domestic manufacture, though this is not common.
10	**WET Claim** Having deferred the WET tax credit through the supply chain, the last wholesale supplier charges the WET amount on their sale and returns this amount to the ATO via normal business activity statements (BAS), while claiming a WET credit on their initial supply.

[24] See, Australian Taxation Office, *Excise Ruling 2012/1*: the meaning of the expression 'manufactured or produced' for the purposes of the Excise Acts.

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Ref	Alcohol Supply Chain Steps
11	**Manufacture underbond (in domestic consumption)** Even after entering domestic consumption, imported alcohol can still undergo additional manufacturing while under bond to be transformed into new product. While this is unlikely to be common practice (as it more administratively burdensome than manufacturing at step 7), the goods can then return to domestic consumption or be sent for export.
12	**Export movement permission** An export movement permission is required to move excisable goods to a place of export (wharf, airport or depot).
13	**Export Declaration** An Export Declaration must be completed to re-export imported alcohol goods or export manufactured alcohol goods. If the goods had not entered domestic consumption, the export declaration extinguishes any remaining customs duty or excise duty liabilities.
14	**Customs or Excise Duty Drawback** Following the exportation of duty paid alcohol goods, a customs drawback (Form B807) or excise drawback (Form NAT 4287) can be lodged to obtain a drawback on the duty paid for where: • those goods were treated, processed, or incorporated in other goods for export; or • exported unused since importation.

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Overview

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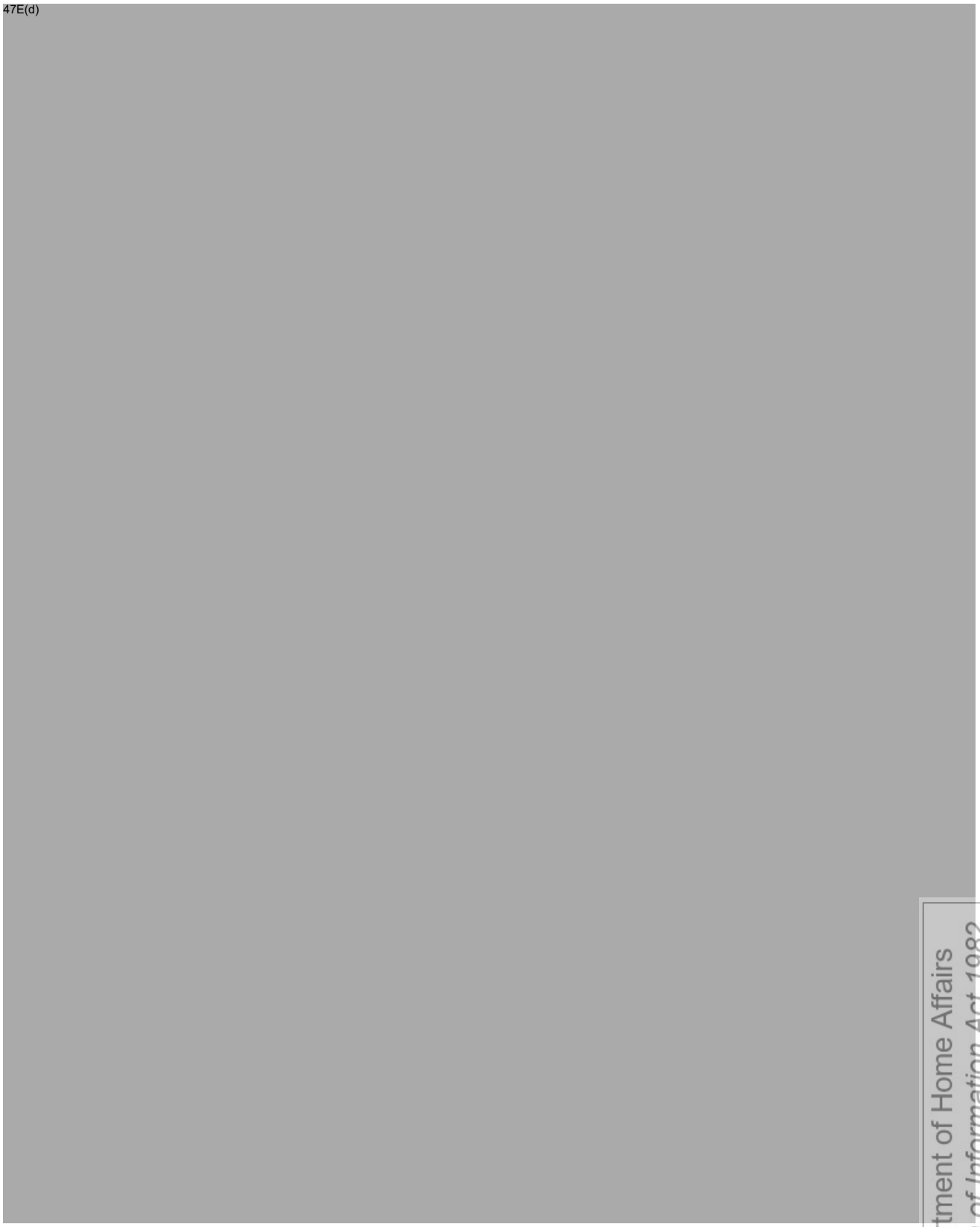

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D. Senate Committee - 2001

Senate Legal and Constitutional Legislation Committee report

The Senate Legal and Constitutional Legislation Committee reported (in May 2001) the results of its Inquiry into the *Customs Legislation Amendment and Repeal (International Trade Modernisation) Bill 2001*, the *Import Processing Charges Bill 2000*, and the *Customs Depot Licensing Charges Amendment Bill 2000*.

The report contained industry evidence of suspicious business practices which represented significant revenue risks at the border. Extracts from that report are included in this attachment. Report extracts follow overleaf.

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The Parliament of the Commonwealth of Australia

Senate Legal and Constitutional Legislation Committee

Consideration of legislation referred

to the Committee

Inquiry into the Customs Legislation Amendment and Repeal (International Trade Modernisation) Bill 2001, Import Processing Charges Bill 2000, and the Customs Depot Licensing Charges Amendment Bill 2000

MAY 2001

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Members of the Legislation Committee

Members

Senator M Payne **(Chair)** LP
Senator K Lundy[1] **(Deputy Chair)** ALP
Senator H Coonan LP
Senator B Cooney ALP
Senator B Mason LP
Senator B Greig AD

Participating Members

Senator A Bartlett
Senator B Brown
Senator G Chapman
Senator A Eggleston
Senator A Ferguson
Senator M Forshaw
Senator B Harradine
Senator S Knowles
Senator J. Ludwig
Senator A Murray[2]
Senator N Stott Despoja
Senator J Tierney
Senator the Hon N Bolkus
Senator P Calvert
Senator W Crane
Senator the Hon. J Faulkner
Senator J Ferris
Senator the Hon. B Gibson
Senator L Harris
Senator R Lightfoot
Senator J McGauran
Senator C Schacht[3]
Senator T Tchen
Senator J Watson

Secretariat

Dr Pauline Moore (Secretary to the Committee)
Ms Yvonne Marsh (Principal Research Officer)
Ms Sonia Hailes (Executive Assistant)

PARLIAMENT HOUSE
CANBERRA ACT 2600
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1 Appointed as a substitute member for Senator McKiernan for the Customs Legislation Amendment & Repeal (International Trade Modernisation) Bill 2000, Import Processing Charges Bill 2000, and the Customs Depot Licensing Charges Amendment Bill 2000

2 Appointed as a participating member for the Customs Legislation Amendment & Repeal (International Trade Modernisation) Bill 2000 & related Bills

3 Appointed as a participating member for the Customs Legislation Amendment & Repeal (International Trade Modernisation Bill 2000 & related Bills

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SUPPLEMENTARY REMARKS

SENATOR ANDREW MURRAY: AUSTRALIAN DEMOCRATS

1.1 I wish to make a few additional remarks concerning these bills and matters arising from the Inquiry and the Report. In particular the issue concerning large scale avoidance of tax and duty.

A: Chapter 2

Main Report Paragraph 2.17

1.2 In this paragraph is the following seemingly innocuous statement in the last dot point:

> Other measures in the ITM Bill aimed at improving export control include:…requiring an export entry for all goods the export of which requires a permission…certain goods (such as passenger/crew baggage, lower value items) are exempt from lodging an export entry…For example…pharmaceuticals…are currently not declared….The amendment means…that pharmaceuticals in crew luggage must be declared.

1.3 I did not pick this up before in reading the Explanatory Memorandum and in the Hearing. If airline staff are carrying prescription or over-the-counter drugs should they have to report it to Customs? Why? And if crew, will passengers too? Of any value, regardless? On the face of it this seems excessive. A requirement for all airline staff to report all their pharmaceuticals, assumingly for personal use, could become quite onerous, and seems really unnecessary unless there is a good explanation, which I will seek in the Senate.

B: Chapter 3

Main Report Paragraph 3.16

1.4 The Committee has recorded its concern that business still claims that it has not been provided with adequate cost impact assessments. The Minister should provide an assurance that they will do so.

Main Report Paragraph 3.26

1.5 This paragraph begins the discussion on the Strict Liability Offences and Penalty Regime. I am concerned about the full ramifications of strict liability provisions now sweeping through all federal legislation. I am wary that in many cases strict liability provisions may represent a permanent shift to a harsher regime, and that could be prejudicial to principles of natural justice. Given the level of concern expressed in this Inquiry by industry and the legal profession, given the claims from the New Zealand Government (see last dot point 3.43) that it did not appear to achieve the expected outcomes, and given the level of discretion which appears to be inherent in the regime, the parliament will need to carefully evaluate the consequence of these increases in the power of Customs.

1.6 The Report discusses the issue of merits review, and the absence of recourse to the AAT in certain circumstances. It should be noted that persons aggrieved or concerned by the

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application of the new strict liability offences and penalty regime are still able to access the Ombudsman for investigation and report. In the absence of merits reviews or AAT access, this is a useful constraint, particularly given the perceived levels of Customs discretion in the new bills.

C: Other Matters

1.7 What is missing in the Committee Report is any significant discussion of the practical difficulties of the business processes within the Bill. Although the AEIA was the only submission to deal with them (because it was the only submission to come from a group of direct importers/exporters rather than service agencies who just pass on the costs), a number of AEIA points are still valid.

1.8 The Bill requires Accredited Clients to send electronically to Customs at least one periodic declaration not later than the first day of the following month (new section 71DF(b)). The AEIA argued that:

> The 'one day' proposal has little or no regard to either the financial reporting cycles or in-house systems of Customs' client base of importer and exporters. There is no inexorable logic in the ABS position.[1]

1.9 Also:

> Reporting times should be brought in to line with the BAS reporting times for monthly settlement, i.e. 21 days after the end of the period, through amendment to the legislation.[2]

1.10 This seems to makes sense, and I note that the Ernst & Young supplementary submission of 20 April refers to the usefulness of interacting with BAS when possible:

> More importantly, it is also seen as a 'stepping stone' to further business tax reforms, for example the reporting and payment of Customs and Excise duties via the Business Activity statement…[3]

1.11 Section 71DF (b) would see the Government introducing two different reporting cycles for revenue collection activities. This poses practical compliance difficulties for business. It would seem desirable for the ATO and ACS reporting cycles to be aligned by amending this section.

1.12 The AEIA argued that: *…business should have a right to nominate an authorised company officer to answer questions posed by a monitoring officer.*[4] Note that a failure to answer a question put under this subsection 243SA is an offence, and could therefore be a difficult experience for some junior employees. The AEIA idea seems sensible, particularly with respect to large organisations. The downside is that such an approach could be used by some companies as a delaying device. To effect the AEIA suggestion would require an

1 *Submission 10,* Australian Exporters and Importers Association, p. 4

2 *Submission 10,* Australian Exporters and Importers Association, p. 6

3 *Submission 7A,* United Distillers & Vintners (Aust) represented by Ernst & Young, p.2, paragraph 3

4 *Submission 10,* Australian Exporters and Importers Association, p. 15

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amendment to Section 214AH of the bill, which currently states *...a monitoring officer... may require any person on the premises to answer any questions put by the monitoring officer.* If AEIA's proposal were to be accepted I would suggest that in the absence of the nominated company officer then Customs should still be able to ask anyone else they need to.

D: Large Scale Avoidance of Tax and Duty

1.13 In the Customs Legislation Amendment and Repeal (International Trade Modernisation) Bill 2000, Explanatory Memorandum General Outline, is this statement:

> The first set of powers are necessary because both Customs and the ATO have identified that goods under Customs control that are said to be bound for export are instead going into Australian commerce, with the net result that tax and duty that is properly payable is not being paid.
>
> The ATO believes diversion in Australia is comparable to levels overseas, **which are in the order of 30%.** Customs has also identified that this diversion activity is widely undertaken at various stages of the underbond process. [5] (emphasis added)

1.14 I was frankly taken aback by the allegations in the Explanatory Memorandum, especially since in the EM there was no indication that Customs, the ATO or the Police had ever done anything to recover these monies. I was just as taken back by E&Y/UDVA's supporting evidence that 30% or more of supposedly exported spirits are diverted back into the domestic market and therefore avoid tax and duty.

1.15 (It occurs to me now to question whether the concessional method recorded in 3.84 has contributed to this situation.)

1.16 The Committee's Hansard of 2 April 2001 has this exchange recorded:

> **Senator MURRAY**—Mr Preece, at the top of page 6 of your submission it says:
>
> … the statistic of 30% of non-export of underbond goods may even be an understatement of the problem.
>
> What does 30 per cent represent in money?
>
> **Mr Preece**—In our particular industry?
>
> **Senator MURRAY**—Yes.
>
> **Mr Preece**—We have had discussions on this. It could be tens of millions of dollars. It is difficult to put an exact number on it. These are very early thoughts. We are working on some studies of the export of just Scotch whisky at this stage—I should say re-export because there is no whisky made in Australia. UDV has seen some highly irregular transactions with that. For example, we have seen container loads of goods which were purportedly holding a number of litres of alcohol which physically cannot fit within the container and whisky moving to markets which are not traditional whisky markets, and so forth. There have been a number of very

5 *Explanatory Memorandum*, Customs Legislation Amendment Repeal (International Trade Modernisation) Bill 2000, pp. 7-8

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unusual transactions coming out of that report and the study we are working on. Next we will move to brandy and liqueurs.

Senator MURRAY—Can I ask you on notice, through the chair: could you provide some working sheets to validate that conclusion of yours?

Mr Preece—Yes.

Senator MURRAY—If it is commercially sensitive, you can, of course, provide it in confidence. That is a substantial claim and I think we need two things: firstly, to indicate how you have arrived at it and, secondly, to indicate your estimation of the total value in your industry. Obviously, you cannot do it with other industries. Customs often do not have many friends, but the idea that they are absolutely incompetent seems a bit far-fetched to me. This parliament has one or two items stolen from it regularly. If a third of everything in the parliament disappeared, we would expect the culprits to be found pretty quickly.

….

Senator MURRAY—Let us assume a third of all these chairs, a third of all the equipment, a third of everything in the parliament—it becomes ludicrous. What the statement of yours says is that a third of all under bond goods may be going missing, being used for purposes for which they are not intended. That implies or states incompetence on a grand scale and it is very difficult to believe.

Mr Preece—The 30 per cent actually had its origin in the EM to the bill; that is where the number first came from.

Senator SCHACHT—This is a customs figure.

….

Senator MURRAY—My concern, Mr Preece, is this: if you are right, this is a national scandal of astonishing scale….

….

Senator SCHACHT—Thank you very much. I notice, Mr Preece, on the page 6, down the bottom, you also raise the GST free status of exports. Of course, exports are GST free and it is understood. It says:

However, where an exporter overstates the quantity and the value of the goods that it is exporting, there will be a number of adverse consequences. Firstly, there will be an overstatement of the value of GST-free exports on the relevant Business Activity Statement (BAS). Primarily this means that the GST net amount will be understated.

A second likely consequence, which is yet to be measured, is the GST treatment by the exporter of those goods purportedly exported, but diverted back into the domestic market. Those goods are classified as taxable supplies when sold in Australia ... The ‘exporter’ may on-sell to another business in Australia, then through the tax invoice/ABN/input tax credit system, we may see GST being remitted on the sale.

Is there any difference in that problem of GST not being paid on the diversion back into the domestic market, compared with the excise—the 30 per cent figure that Senator Murray and you mentioned.

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> **Mr Preece**—That is merely an MO—that is really a possibility that has not been explored. If we were to be creative, that is one way in which you could use this process.
>
> **Senator SCHACHT**—You are saying that the present system could allow that to happen, but that the new proposals in this bill make it less likely that GST could be avoided if the bonded goods were re-diverted back into the Australian market?
>
> **Mr Preece**—It is a support of the tightening of the export controls, the intention of which is to stop this sort of thing happening.

1.17 It will be evident that these revelations surprised a number of Senators at the Hearing. Subsequently E&Y/UDVA provided additional information to the Committee. This information is of sufficient import for me to reproduce it at Attachment A.

1.18 The Committee's coverage of what is as I understand is a hitherto unknown tax rort scandal is curiously understated. (As indeed is the coverage in the EM). Obvious questions arise – such as what have Customs or the ATO been doing about these issues? There is the matter of punishing those who (on this evidence) have engaged in large scale tax and duty evasion. Have there been police investigations? If not, why not? The extensive spreadsheets the Committee has been provided with (the E&Y/UDVA supplementary submission of the 20 April) seem to provide a sound basis for successful investigations of these matters.

1.19 Not only do Customs and the Police usually have reciprocal access to their counterparts in many countries overseas, not only do they have details of who claimed export licences, but receiving countries themselves would know whether the goods had been received by them and from whom, because duty is applicable there. On the face of it, it is difficult to see that it can be hard to establish the veracity of (for instance) claimed exports of Scotch Whisky from Australia to Scotland.

1.20 I have made just one calculation to arrive at an indicative value of what is being alleged. On p7, 3.2.8 of the E&Y supplementary submission they say:

> UDVA believes that an approximate total of 463 198 lals of whisky constituted a very high risk of being diverted back into the domestic market.[6]

1.21 Excise duty on whisky is $54.56 per lal. So, if these suspicions were realised, over $25 million of excise was avoided last year. That is just whisky. Other spirits and other high value goods enlarge the alleged revenue loss considerably.

1.22 In my opinion E&Y/UDVA have provided enough prima facie material to justify an independent Inquiry or a police investigation.

1.23 The Report quotes both UDVA and AEIA to support the bills proposals' for better controls. UDVA seem to think that these bills will assist in preventing revenue leakage of a very high order.

1.24 We need to be aware of the other arguments from the rest of industry, who are concerned about the potentially wide application of these new export control measures. They

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6 *Submission 7A,* United Distillers & Vintners (Aust) represented by Ernst & Young, p. 7

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have recommended that the legislation be amended so as to introduce a mechanism to narrow the application of these new control measures to areas of nominated risk.

Senator Andrew Murray, Participating Member

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ATTACHMENT A TO SENATOR ANDREW MURRAY'S SUPPLEMENTARY REMARKS

FROM ERNST & YOUNG/UDVA SUPPLEMENTARY SUBMISSION 20 APRIL 2001:

DIVERSION OF GOODS FOR EXPORT INTO THE AUSTRALIAN MARKET

You will recall UDVA was fully supportive of the proposed export controls, based on its experience with:

- The risk of diversion of goods back into home consumption without payment of GST and duty, or after successfully claiming duty drawback;
- The emerging trade issue of parallel exporting which the Australian Government is coming under pressure to address; and
- Falling quality of export data for research.

QUANTITATIVE EFFECT ON UDVA

Senator Murray has asked us to provide an estimate in dollar terms of the effect on UDVA of the diversion of goods for export into the Australian market. UDVA of course makes the sale into the Australian market and derives income, however, subsequent parties in the supply chain acquire the spirit for phoney export and diversion into home consumption. However, more important to UDVA than its initial sale is the damage to the reputation of its premium brands through the 'black market" back into the local supply chain. Further damage is done when licensed distributors of those premium brands find that they are no longer enjoying the sole distributor status for which they have paid, and are in fact competing against the "back of the truck" scenario which can offer duty free pricing.

Damage to a brand's reputation is difficult to quantify in dollar terms, but within the industry dollar value does become an issue if ever sole distribution rights were to be put up for sale and realised below expectation. Fortunately UDVA has not yet been put into this position.

DIVERSION OF 30% OF EXPORTED PRODUCT BACK INTO THE DOMESTIC MARKET

Senator Murray queried the estimated rate of such diversion which was put at 30% of under bond exports. The UDVA submission suggested that this figure may even be an understatement of such activity. The 30% figure is not a UDVA nor Ernst & Young figure but was taken from the Explanatory Memorandum to the *Customs Legislation Amendment*

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And Repeal (International Trade Modernisation) Bill 2001 (ITM Bill).[1] Such a figure derives from experiences in overseas jurisdictions in regard to the diversion of export of highly taxed products back into home markets.

Having said that, UDVA is able to highlight a significant quantity of highly irregular and suspicious alcohol export transactions, which constitute a high risk of diversion back into the domestic market. Based on a small sample of spirits exports, namely the export of whisky during calendar year 2000, (which may or may not be representative of all exported alcoholic products) UDVA believes that there is cause for alarm.

As part of a separate exercise to this Senate Committee, UDVA did seek from Customs, under Freedom of Information legislation, a report on all whiskey exports for the year 2000. Using industry knowledge and expertise as to the patterns of distribution, UDVA was able to identify significant numbers of export transactions that in its opinion, are highly suspicious. This does not necessarily mean that every one of these suspicious transactions was actually diverted in full or in part back into the Australian market, but rather there is a high risk of it happening.

Following is our analysis of the Customs report:

Unsanctioned exports

UDVA views any unauthorised export of a UDVA product from Australia as suspicious. This is because United Distiller & Vintners (UDV) has established sole distribution licence arrangements globally for each of its brands. Under such arrangements, no UDV label should be leaving Australia unless it is either:

- by UDVA itself or an authorised user of it trade marks to licensed distributor in the regional market; or
- as part of ship or aircraft stores (where the product is consumed on board); or
- as duty free shop sales to departing passengers.

During 2000, **35,468** litres of alcohol (lals) of UDV whiskey product were reported as exported, either under bond or as duty paid (subject to drawback), for which neither UDVA nor an authorised user of UDVA's trade marks was sanctioned by UDVA giving its permission to use the trade mark.

Nor in the case of duty drawback claims, did Customs or the exporter seek certification from UDVA that duty was actually paid as per Customs guidelines.

Export consignments which appear not to physically fit within the confines of a shipping container (excluding Thailand see 3.2.4 below)

Please note that UDVA's analysis in this section is based on the size limitation of a 40-foot container. In some exports, containers would have been 20-foot in size, and in this situation the risk is double what UDVA has stated below.

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1 Explanatory Memorandum to the *Customs Legislation Amendment Repeal (International Trade Modernisation) Bill 2000* at p. 5

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The whisky export report from Customs reveals that there were 70 instances where the physical capacity of a 40 ft container had been well exceeded. This could in fact mean that several containers were used for one consignment, however there are two further considerations:

- firstly, a consignment is also likely to include other spirits to fill an order – for example, brandy, rum and liqueurs; and
- secondly, given the highly structured supply chains around the world, multiple container assignments are unusual and usually not required to fill gaps in another market.

Under this category of analysis, **74,430** lals were identified (extending to 148,860 lals if 20 ft containers were used).

Export of unrealistic quantities to minor markets

Please note that in this analysis UDVA has only included those minor markets that are clearly not trans-shipment or 'hub' points to other markets.

UDVA views the quantity of exports to the markets listed in the following table as suspicious as they are unrealistic given the size of the market, the fact that other spirits products will have also been imported, the cultural attributes of the market and, in some cases, the physical limitations as to the size of a ship that can enter its ports.

The following is a summary of the volume of suspicious exports to minor markets:

Market	*Number of lals*
Vanuatu	14,680
Indonesia	70,440
Fiji	14,294
TOTAL	**99,414**

Exports to markets where established distribution rights exist

UDV is not the only owner of premium brand spirits which is distributed under global licensing arrangements and so questions why so much whisky needs to leave Australia and enter markets where exclusive distributions rights have already been established with the owner of that brand. UDVA also queries how this is actually allowed to happen in the ultimate market of destination, given that products exported from Australia will clearly be

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marked in English for consumption in Australia and labelling will most likely breach local labelling laws in the export market. UDVA is also aware that anti parallel importing legislation exists in most of the markets concerned and importers face penalties and forfeiture of the spirits.

The following table contains the details of the volume of suspicious exports to foreign markets where UDVA expects there would clearly established sole distribution rights:

Market	***Number of lals***
Hong Kong	39,353
Indonesia	70,440
Japan	78,870
Netherlands	31,912
TOTAL	**220,575**

Under this category there were exports of **220,575** lals of whisky product regarded as suspicious.

Exports to Thailand

Total whisky product exports to Thailand were **1,754,262** lals last year which does not fit within any logical distribution pattern unless spirit is further transhipped from this point. This represented 69% of the total volume of whisky product (in lals) exported from Australia. As the volume of exports to Thailand is so large, UDVA has not included this figure in its analysis (apart from at 3.2.2 where the consignments do not fit within a 40 ft shipping container) as it believes this number may skew its results.

However, suffice to say Thailand, like any other market has established distribution rights for premium brand spirits eg Riche Monde (Bangkok) Ltd owns the sole distribution rights for Johnnie Walker and Riche Monde Ltd's Johnnie Walker products are clearly marked for the Thai market.

Importantly, Australian market Johnny Walker product fails the local regulations surrounding packaging and an imported bottle from Australia would not conform to this standard and the importer faces having stock readily identified and seized by officials. UDVA believes a significant amount of these spirits exports are suspicious.

Exports from East Coast – Customs Drawback Claim Lodged in Adelaide

Customs reports do not show which export transactions fall into this category, however, UDVA understands from various communications with Customs that this is a regular event. UDVA is aware that Customs has certain electronic capabilities to allow for optional port lodgement, but questions why the practice appears so common in the drawback of spirits.

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UDVA question Customs risk management responses, and whether they would view this as suspicious, and then how they can possibly react adequately where the documentation and the goods are dealt with by two separate Customs offices.

Scotch to Scotland

UDVA believes that it is ironic that Australia would export Scotch to the United Kingdom. This either represents a benchmark for Australian entrepreneurs - being able to sell Scotch whisky back to the Scots themselves who distilled the product (including being able to absorb the addition of freight costs to and from Australia) or a tongue-in-cheek approach to smuggling! In this light, UDVA has identified that **12,638** lals of whisky product are indeed irregular.

Ship stores

The 'ship stores' export coding is used for ship and aircraft operators to take on board whisky to be consumed by passengers during the flight or voyage.

UDVA found no less than 12 flights or voyages where crew and passengers would be required to consume anywhere up to 2000 bottles of whisky! Of those, there were two voyages where the crew would have needed to drink up to a 20-foot container load of whisky. This is obviously unrealistic and UDVA calculates that a total of **20,673** lals were exported in such dubious circumstances.

Conclusion

From the analysis undertaken above and removing all double counting of suspicious transactions from two or more categories, UDVA believes that an approximate total of **463,198** lals of whisky constituted a very high risk of being diverted back into the domestic market. This represents approximately 18.4% of the total volume (in lals) of whisky exported from Australia in the year 2000. However, this figure is a conservative estimate as UDVA used 40ft shipping container figures and did not include those exports to Thailand. Given that approximately 69% of all whisky exports from Australia went to Thailand in 2000, and this in itself is highly unusual and of great surprise to UDVA, if 20% of these exports were indeed at risk of diversion, then the EM figure of 30% as it relates to exports of whisky last year has been reached. Notwithstanding, 18.4% of whisky exports should also represent an unacceptable risk to the Government.

UDVA has since sought further information from Customs on other spirits exports under Freedom of Information, given its concerns over the extent, and the involvement of its premium brand labels.

GST-FREE NATURE OF EXPORTS

Senator Schacht requested information as to which provisions of the proposed legislation provide protection against the leakage of Commonwealth revenue through the GST system.

We believe that the primary provision which will provide such protection is proposed s117AA of the ITM Bill, which prescribes places for the consolidation of goods for export. This provision requires that prescribed goods shall be consolidated only at prescribed places, such as a wharf or an airport.

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As the law stands now, an illegitimate exporter can load a container with spiritous product and deliver that container to a wharf and would be highly "unlucky" to have Customs waiting there for inspection before it is loaded and exported. Under proposed s117AA, there is scope for introducing new controls by making high-risk products, such as spirits, prescribed goods under the Customs Regulations. Consequently, a illegitimate exporter would be required to have their cargo of spiritous products consolidated at a wharf or airport by a third party, for example stevedores.

This primary control as viewed by UDVA, is then supported by the following:

- reporting to Customs by warehouses and wharves as to what is leaving bond and being packed – s114E & s114F;
- increased monitoring powers of Customs/ATO – Div 3A;
- infringement notice regime for non-duty related areas for exports s243X.

Attachments (not enclosed with this Minority Report)

A - Draft submission to Customs on CMR and warehousing

B – Customs CMR pamphlet "Customs Connect Facility"

C – Spreadsheet "Unsanctioned Exports"

D – Spreadsheet "Exports consignment not fitting within shipping containers"

E – Spreadsheet "Exports in unrealistic quantities to minor markets"

F – Spreadsheet "Exports to markets with established distribution rights"

G – Spreadsheet "Exports to Thailand"

H - Spreadsheet "Scotch to Scotland"

I – Spreadsheet "Ships stores"

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