

Administration of Tobacco Excise Equivalent Goods

Australian Taxation Office

Department of Immigration and Border Protection

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Canberra ACT

5 May 2016

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Australian Taxation Office and the Department of Immigration and Border Protection titled *Administration of Tobacco Excise Equivalent Goods*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website—<http://www.anao.gov.au>.

Yours sincerely



Grant Hehir
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

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Summary and recommendations

Background

1. Excise duty (excise) is a tax placed on excisable goods—tobacco, alcohol (excluding wine), and fuel and petroleum products—that are produced or manufactured in Australia. When imported these commodities are treated as excise equivalent goods, and customs duty is imposed at a rate equivalent to excise, to allow consistent treatment of the imported and Australian produced goods. From 2010–11 to 2014–15, the government collected an average of \$8.1 billion in tobacco excise and customs duty each year.

2. The movement and storage of tobacco is controlled through licensed warehouses administered by the Australian Taxation Office (ATO) and the Department of Immigration and Border Protection (DIBP). The goods must be manufactured and/or stored in these warehouses—referred to as being underbond—until they are released for home consumption, moved to duty free outlets or exported. The ATO has administered excise since 1999 (a responsibility under the *Excise Act 1901* transferred from the (then) Australian Customs Service). Under the *Customs Act 1901* DIBP is responsible for administering excise equivalent goods and collecting customs duty. In 2010, the ATO's role was expanded, under powers delegated by the Chief Executive Officer of Customs, to include the management of excise equivalent goods stored in warehouses under section 79 of the *Customs Act 1901* (s.79 warehouses): a measure that aimed to streamline administration of excise and customs duty. Agency roles and responsibilities pertaining to the 2010 delegation are agreed through a head Memorandum of Understanding between the ATO and DIBP and a subsidiary agreement specifically for excise and excise equivalent goods.

Audit objective and criteria

3. The objective of the audit was to assess the effectiveness of the administration of tobacco excise equivalent goods, and the collection of customs duty.

4. To form a conclusion against this objective, the ANAO assessed whether:

- management arrangements between the ATO and DIBP support the effective administration of tobacco excise equivalent goods;
- ATO and DIBP systems and procedures support DIBP's collection of customs duty for tobacco excise equivalent goods; and
- compliance activities for tobacco excise equivalent goods are appropriate and effective.

5. The report did not explicitly examine the administration of tobacco excise, as the production of tobacco and tobacco goods in Australia was diminishing, and ceased during 2015. However, tobacco excise was indirectly covered as there are some common arrangements with excise equivalent tobacco. While the audit has focused on tobacco, common arrangements exist for the administration of other excise equivalent goods (alcohol and petroleum).

Conclusion

6. The ATO and DIBP have established a suitable framework for administering a range of indirect taxes, including customs duty paid on excise equivalent goods, but the framework has not been implemented adequately over the previous five years, and the administration of tobacco excise equivalent goods and the collection of customs duty has fallen short of effective practice.

7. Over this period, DIBP did not meet its obligations under the Memorandum of Understanding to provide access to information and systems to the extent necessary for the ATO to carry out key aspects of its delegated role. Reconciliation of the movement of underbond tobacco with the revenue collected or reported is seldom done, and an absence of suitable warehouse licensing policy and inadequate compliance strategies contributed to a lack of visibility and assurance around tobacco storage. In addition, the assessment of tobacco risks lacked consistency, and compliance activities required a more risk focused and structured approach informed through greater contribution by DIBP.

8. Since mid-2015, there has been a renewed and positive focus within DIBP on arrangements with the ATO for administering tobacco excise equivalent goods. The two agencies are working more closely together to address many long standing issues noted in this report that, when fully implemented, would support more accountable, effective and streamlined administration of excise equivalent goods more broadly.

Supporting findings

Management and reporting arrangements

9. The administrative framework for managing tobacco excise equivalent goods is sound, providing detailed roles and responsibilities for the ATO and DIBP, and an appropriate committee structure. However, the (then) Australian Customs and Border Protection Service did not meet the intent of the agreement by sufficiently engaging with or supporting ATO officers. Specifically, DIBP's decision not to provide ATO officers with the necessary level of access to DIBP's systems limited the ATO's ability to administer its roles and responsibilities under delegated powers for almost five years. This may have also limited the extent of the streamlining of regulatory services for industry participants, limited the effectiveness of the selection and conduct of risk and compliance activities for tobacco excise equivalent goods, and reduced the level of assurance that the correct amount of tobacco customs duty was being collected. There is no evidence that the ATO invoked dispute resolution processes set out in the head Memorandum of Understanding between the ATO and (then) Australian Customs and Border Protection Service to resolve the issue in a timely way.

10. From mid-2015, the newly established DIBP (following integration with the Australian Customs and Border Protection Service) has renewed engagement with the ATO to address many long standing issues related to the management of excise equivalent goods. Nevertheless, problems remain in exchanging information between the agencies, and the development of reporting mechanisms to the Secretary of DIBP and the Commissioner of Taxation would provide ongoing assurance that the arrangement is being managed effectively.

11. There is no calculation or reconciliation that provides assurance that the correct amount of customs duty is being collected and reported:

- neither the ATO nor DIBP examines the value of the charges due from the physical quantities of imported tobacco goods moved into the underbond system, and the actual volume of these goods (and customs duty paid) reported entering the domestic market;
- revenue (excise and customs duty) collected from tobacco goods is reported in Australian Government Budget documents, against forward estimates based on projected consumption (that include assumptions about fluctuations in demand, for example due to increases in excise rates). The assumptions do not factor in the size of the illicit trade in tobacco and potential changes to the supply of and demand for dutiable goods as a result of the increase in costs in the legitimate market; and
- the size of the trade in illicit tobacco (and value of revenue lost) has been the subject of much analysis, but the various results have not been agreed by key government and industry stakeholders. As at February 2016, the ATO was developing a tax-gap estimate for tobacco that will provide an estimate of the value of the illicit tobacco market and resultant revenue foregone.

Licensing s.79 warehouses administered by the ATO

12. The ATO has applied excise licence policy and process to excise equivalent licences, although the licences are issued under different legislation, the *Excise Act 1901* and the *Customs Act 1901* respectively, and no analysis of the requirements of the Acts has been conducted. With regard to tobacco, the ATO has focused on the administration of excisable goods, although the cessation of the excise tobacco industry in Australia (and a corresponding increase in revenue from customs duty) has been foreshadowed for several years. The ATO could have been more active in its administration of licensing for s.79 warehouses under its administration.

13. The process for issuing and renewing a licence to operate a s.79 warehouse administered by the ATO could be improved. The ATO has changed the wording on licences to more clearly identify the goods that may be stored in a warehouse, and is developing a new checklist for the application process, but more could be done. The number of criminal history checks on licence applicants has been reduced, but the ATO has not analysed the impact of this on incidences of non-compliance.

Risk and compliance

14. Risks associated with the administration of tobacco excise equivalent goods have not been consistently assessed. Fluctuations in the annual risk rating (from 'low' to 'moderate' to 'significant') lacked a clear rationale, with the most recent rating based on reputational risk to the ATO and DIBP. The shared administration of this risk between the ATO and (then) Australian Customs and Border Protection Service has been ad hoc and informal. There has been little evidence that the expectations of the relationship have been met regarding access to and the timely exchange of: knowledge and expertise of risk staff; and risk-related information, both ongoing and as part of the annual risk management process.

15. The planning and implementation of compliance activities for excise equivalent goods moving in and through s.79 warehouses administered by the ATO could be improved, including

by DIBP engaging with the ATO as set out in the administrative framework. Within the ATO, there is a lack of process for the selection of warehouses (or other aspects of the tobacco industry) for targeted compliance activities, relying heavily on manual assessment. Testing of a sample of completed compliance activities for tobacco excise equivalent goods indicated the need for better recording in the ATO's systems.

Recommendations

Recommendation No.1 To support the administration of excise equivalent goods, the ANAO recommends that:

Paragraph 2.19

- (a) the ATO reviews and, subject to competing information technology priorities, improves the information technology platform currently in use; and
- (b) DIBP and the ATO improve the exchange of information between the respective agencies.

ATO response: *Agreed.* **DIBP response:** *Agreed.*

Recommendation No.2 To support the issuing and renewal of licences for operators of s.79 warehouses administered by the ATO, the ANAO recommends that the ATO develops specific guidelines and procedural documentation for the administration of s.79 warehouses under ATO control.

Paragraph 3.5

ATO response: *Agreed.* **DIBP response:** *Agreed.*

Recommendation No.3 To improve the assessment of risk associated with the administration of excise equivalent goods, the ANAO recommends that the ATO and DIBP develop working arrangements to share risk related information and intelligence and assess risks based on evidence and a joint understanding of the risk environment.

Paragraph 4.13

ATO response: *Agreed.* **DIBP response:** *Agreed.*

Recommendation No.4 To improve the effectiveness of compliance activities associated with the storage and movement of excise equivalent goods, the ANAO recommends that:

Paragraph 4.34

- (a) DIBP engages with the ATO to coordinate compliance activities in s.79 warehouses, in accordance with the head Memorandum of Understanding;
- (b) the ATO develops more specialised and systematic processes for selecting warehouses (or other aspects of the tobacco industry) for targeted compliance activities; and
- (c) the ATO reinforces and monitors the appropriate recording of tobacco excise warehouse compliance activities.

ATO response: *Agreed.* **DIBP response:** *Agreed.*

Summary of entity responses

16. The ATO's and DIBP's summary responses to the report are provided below, while their full responses are at Appendix 1.

ATO response

The ATO welcomes this review and considers the report supportive of our overall approach to managing the administration of Tobacco excise equivalent goods under delegation from the Chief Executive Officer of Customs.

The review recognises that the ATO is committed to working closely with the DIBP to further enhance our administration and compliance approach. The audit identified a number of opportunities for improvement in our administration and risk assessment processes which the ATO will work more closely with the DIBP.

The ATO agrees with the four recommendations contained in the report.

DIBP response

The Department of Immigration and Border Protection (the Department) accepts the four recommendations presented in the report on the *Administration of Tobacco Excise Equivalent Goods* and acknowledges that further work is required to improve the cooperative relationship between the Department, the operational arm of the Department—the Australian Border Force (ABF) and the Australian Taxation Office (ATO) in the administration of Excise Equivalent Goods (EEGs).

Since the integration of the Department and the Australian Customs and Border Protection Service (ACBPS), the Department and the ABF have strengthened ties with the ATO through developing channels for information sharing, joint operations and other pathways to ensure appropriate treatment of risk around EEG goods at and beyond the border. The report reinforces the importance of this work. The Department and the ABF will continue to develop a close and collaborative working relationship in the indirect tax and EEG space.

The Department notes that the report provides examples of importations of illicit tobacco and includes discussion on the illicit tobacco market. While illicit tobacco presents complementary risks, these do not directly impact the administration of the EEG regime. The Department believes the illicit tobacco market is not indicative of the effectiveness of EEG administration by either the ATO or the Department.

Audit Findings

1. Background

Introduction

1.1 Excise duty (excise) is a tax placed on excisable goods—tobacco, alcohol (excluding wine¹), and fuel and petroleum products—that are produced or manufactured in Australia. When imported, these commodities are treated as excise equivalent goods, and customs duty² is imposed at a rate equivalent to excise to allow consistent treatment of the imported and Australian produced goods. The legislative framework for the administration of excisable goods and excise equivalent goods, and the collection of excise and customs duty, is set out in Table 1.1.

Table 1.1: Legislative framework for the collection of excise and customs duty

Excise	Customs duty
<i>Excise Act 1901;</i> <i>Excise Tariff Act 1921;</i> and <i>Excise Regulation 2015.</i>	<i>Customs Act 1901;</i> <i>Customs Tariff Act 1995;</i> and <i>Customs Regulation 2015.</i>

Source: Department of the Treasury consultation paper, *Excise Equivalent Goods Administration*, August 2012, pp. 6–7.

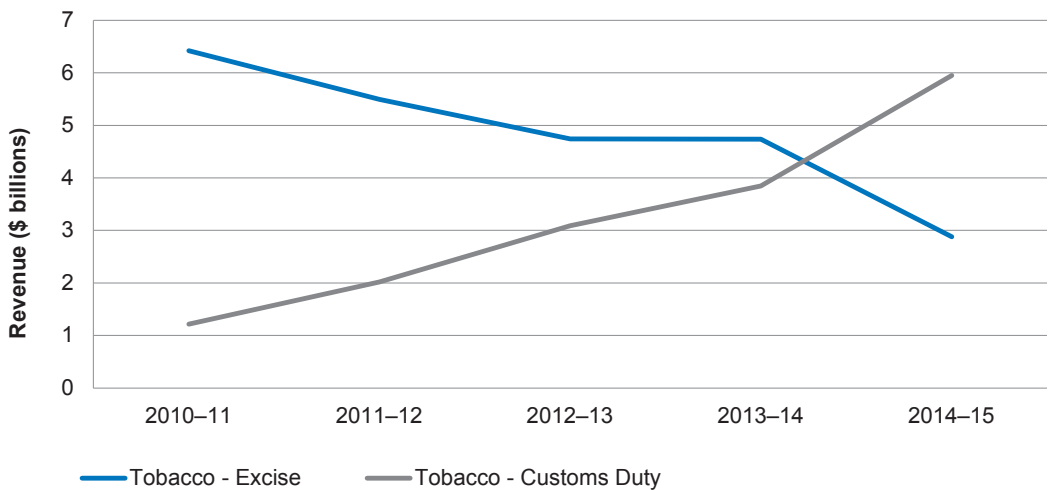
1.2 Excise (and customs duty) can also be applied selectively to pursue non-revenue objectives. In the case of tobacco (and tobacco products), increases in excise rates have been justified by the ‘strongly addictive qualities of tobacco, its serious health impacts, its uptake by minors and the costs that smoking imposes on non-smokers’.³ Over the period 1999 to 2015, excise rates for tobacco increased 654 per cent. From 1999, in addition to indexing for inflation⁴, excise rates for tobacco and tobacco products were subject to a one-off increase of 25 per cent in April 2010, with four further annual increases of 12.5 per cent imposed as part of the *National Tobacco Strategy 2012–2018* (to take effect between 2013 and 2016).

Revenue raised from excise and customs duty

1.3 In the five year period, 2010–11 to 2014–15, the government collected an annual average of \$31 billion per year in excise and customs duty: \$17.8 billion from petroleum; \$5.1 billion from alcohol; and \$8.1 billion from tobacco. The relative proportion of excise to customs duty from tobacco products decreased significantly over the same period, as the Australian industry moved from domestic to imported product (Figure 1.1). By mid-2016, stocks of Australian produced tobacco will be exhausted and no further excise revenue is expected from tobacco.

-
- 1 Wine consumed in Australia (either imported or domestically produced) is subject instead to a wine equalisation tax, based on the value of the wine and generally applied to the last wholesale sale.
 - 2 In this report, unless otherwise stated, customs duty refers to the charges imposed on excise equivalent goods when they are released for domestic consumption.
 - 3 Department of the Treasury, *Post-Implementation Review: 25 per cent Tobacco Excise Increase*, February 2013, p. 1.
 - 4 Tobacco excise is levied per cigarette (stick) or per-kilogram. As at September 2015, the excise rates were \$0.53 per stick and \$663.72 per kilogram of tobacco content. Rates increase in March and September each year, based on movements in average weekly ordinary time earnings.

Figure 1.1: Excise and customs duty collected from tobacco, 2010–11 to 2014–15



Source: ANAO analysis of ATO and DIBP data.

Administration of excisable and excise equivalent goods

1.4 Goods subject to excise must be manufactured and or stored in licensed premises or warehouses—referred to as being underbond—until the excise liabilities are paid and the goods can be: released into the Australian domestic market for home consumption; moved for sale in duty free outlets; or exported. Similar underbond arrangements apply to excise equivalent goods: once cleared by the Australian Border Force at the port of entry, the goods must be moved into and stored in a licensed warehouse until customs duty liabilities are paid.⁵

1.5 The system of licensed warehouses and permissions⁶ (to move excise and excise equivalent goods) is administered by the Australian Taxation Office (ATO) and the Department of Immigration and Border Protection (DIBP).⁷

1.6 The ATO has administered all aspects of the excise system (including the licensing of premises for the manufacturing and storage of excisable goods and the collection of the tax) since 1999, when the responsibility for excisable goods under the *Excise Act 1901* (Excise Act) was transferred from the (then) Australian Customs Service to the ATO. The rationale for the change was that, as an indirect tax, the administration of excise laws should be integrated with that of

5 Importers may elect to pay customs duty at the port of entry into Australia, allowing direct delivery into the domestic market (goods would not be put underbond).
6 It is an offence under section 61 of the *Excise Act 1901* and section 33 of the *Customs Act 1901* to move or interfere with underbond goods, without the required permission.
7 On 1 July 2015, the Australian Customs and Border Protection Service was integrated with DIBP, establishing the Australian Border Force—the operational arm of the department dealing with border control—within DIBP.

other taxation laws. The transfer of responsibility to the ATO was supported through legislative amendment in 2001.⁸

1.7 From 1 July 2010, administration of excise equivalent goods was also transferred to the ATO from the (then) Australian Customs and Border Protection Service, following a recommendation in the Productivity Commission's *Annual Review of Regulatory Burdens on Business: Manufacturing and Distributive Trades, 2008*, to minimise duplication of revenue administration and compliance costs for excise and excise equivalent goods. In November 2009, the (then) government announced that the ATO would take responsibility for the administration of all excise equivalent goods 'to cut red tape and reduce compliance costs for business by delivering a single administration for businesses to deal with'.⁹

1.8 The arrangement (for the administration of excise equivalent goods) operates under powers delegated by the Chief Executive Officer of Customs to ATO officers (rather than administrative orders or legislative changes), where ATO officers become 'officers of Customs' in the administration of licences for warehouses where excise equivalent goods can be stored, and the control and movement of these goods. DIBP retains responsibility for border activities relating to excise equivalent goods, and importers of these goods that are warehoused continue to use DIBP's Integrated Cargo System (ICS)¹⁰ to report and enter the goods for warehousing, and to pay the customs duty.¹¹

Licensing

1.9 Warehouses that are used for the manufacture and/or storage of excisable goods must be licensed under Part IV of the Excise Act; and for excise equivalent goods, warehouses must be licensed under section 79 of the Customs Act (referred to in this report as ATO administered s.79 warehouses). A licensed warehouse may be a:

- private warehouse, where the licence holder is the owner of the warehoused goods; or

8 On 21 October 1998, an Administrative Arrangements Order transferred the excise function from the Australian Customs Service to the ATO, with effect from 1 February 1999. Legislative change in 2001, the *Taxation Laws Amendment (Excise Arrangements) Act 2001*, transferred responsibility for all aspects of tobacco excise legislation to the ATO.

9 The Hon Lindsay Tanner MP, Minister for Finance and Deregulation, and The Hon Brendan O'Connor MP, Minister for Home Affairs, Media release, 30 November 2009, available from <<http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/099.htm&pageID=&min=njsa&Year=2009&DocType=0>>, accessed 7 March 2016.

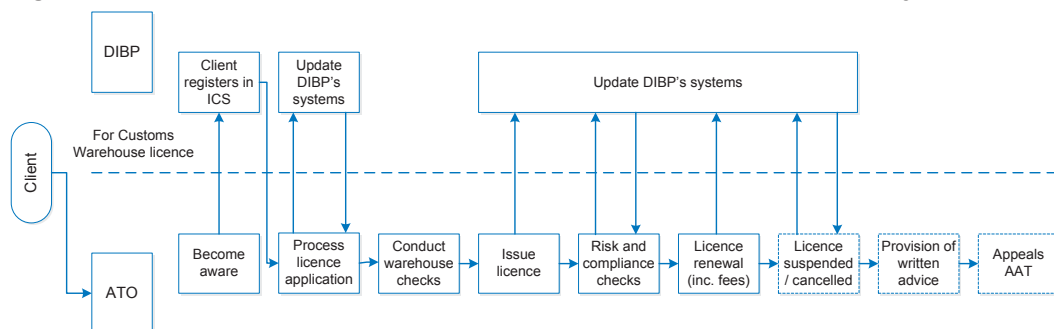
10 DIBP's Integrated Cargo System (ICS) is the Department's single system for the management of imports and exports. The system accepts information provided by importers and exporters as well as transport and logistics service providers and provides the Department and other government agency authority for cargo movement and clearance. Advice from the ATO website, <<https://www.ato.gov.au/Business/Excise-and-excise-equivalent-goods/Excise-equivalent-goods/Customs-warehouse-licences/>>, accessed 18 November 2015.

11 Australian Customs and Border Protection Service, *Compliance Update, December 2009*. Available from <<https://www.border.gov.au/Complyingwithyourobligations/Documents/complianceupdatedec2009.pdf>>, accessed 7 March 2016.

- general warehouse, where the licence holder is storing goods on behalf of the owners of the goods.¹²

1.10 An application for a licence for premises where excisable goods can be manufactured and/or stored is available from the ATO website, and should be lodged with the ATO. Similar arrangements are in place for a licence to operate an ATO administered s.79 warehouse, although it is a requirement that an applicant must first register as a client with DIBP's Integrated Cargo System. Warehouses that are used to store both excise and excise equivalent goods must be dual licensed. An overview of the licensing process for s.79 warehouses administered by the ATO is shown in Figure 1.2.

Figure 1.2: Administration of licences for s.79 warehouses administered by the ATO



Note: AAT is the Administrative Appeals Tribunal.

Source: ATO Learner Guide, *Excise Equivalent Goods Introduction*, p. 24.

Permission to move excisable goods and excise equivalent goods

1.11 Applications for permission to move excisable goods underbond (that is, from one licensed premises to another), or for export or to release them into home consumption can be submitted online to the ATO. The ATO processes the applications, and manages all aspects of the lodgement of excise returns and the payment of the tax.

1.12 Similar arrangements are in place with the ATO for permission to move excise equivalent goods underbond, but moving them into home consumption (or for re-export) and the payment of customs duty is conducted through DIBP's ICS. Importers (or their agents) are required to lodge the following:

- for warehousing prior to delivery into the domestic market—a *Nature 20 Warehouse Declaration* (N20) with DIBP to store the imported goods in a licensed warehouse; and
- for delivery from a licensed warehouse into the domestic market—a *Nature 30 Ex-Warehouse Declaration* (N30) with DIBP (for all or part of the goods included in the N20), pay applicable duties, taxes and charges to DIBP, and be issued with an ICS-generated *Authority to Deal* that is presented to remove the goods.

12 Two other categories of licences are administered by DIBP: providores and flight-catering bonds (the licence holder stores goods that are then supplied to international aircraft or vessels as aircraft or ships stores); and duty-free stores (the licence holder is permitted to sell goods to relevant travellers in a retail-type environment). DIBP also issues and has responsibility for licensing customs brokers and agents.

1.13 The agency (the ATO or DIBP) that a business needs to contact in relation to excise equivalent goods and the payment of customs duty is set out in Table 1.2.

Table 1.2: Agency contact for excise equivalent goods—ATO or DIBP

Type of interaction	Type of operator		
	General warehouse operator	Private warehouse operator	Importer/owner of the goods
Licensing—apply, amend and renew	ATO	ATO	N/A
Lodging import and warehouse declarations: N20 and N30	N/A	DIBP (using ICS)	DIBP (using ICS)
Permissions: apply, amend or cancel	N/A	ATO	ATO
Paying—customs duty, indirect taxes	N/A	DIBP	DIBP
Advice—including ICS support and refund and drawback circumstances)	DIBP	DIBP	DIBP
Advice—licensing and permissions	ATO	ATO	ATO
Claiming refunds and drawbacks claims on customs duty	N/A	DIBP (using existing system to claim drawbacks and ICS to claim refunds)	DIBP (using existing system to claim drawbacks and ICS to claim refunds)
Seeking remissions of customs duty	ATO	ATO	ATO
Compliance—post transaction verification for stored goods	ATO	ATO	ATO

Note: N/A = Not Applicable (an importer that is not a private warehouse owner is not responsible for warehouse licensing matters, and a general warehouse operator is not responsible for warehouse declarations or permissions for the goods held on behalf of others).

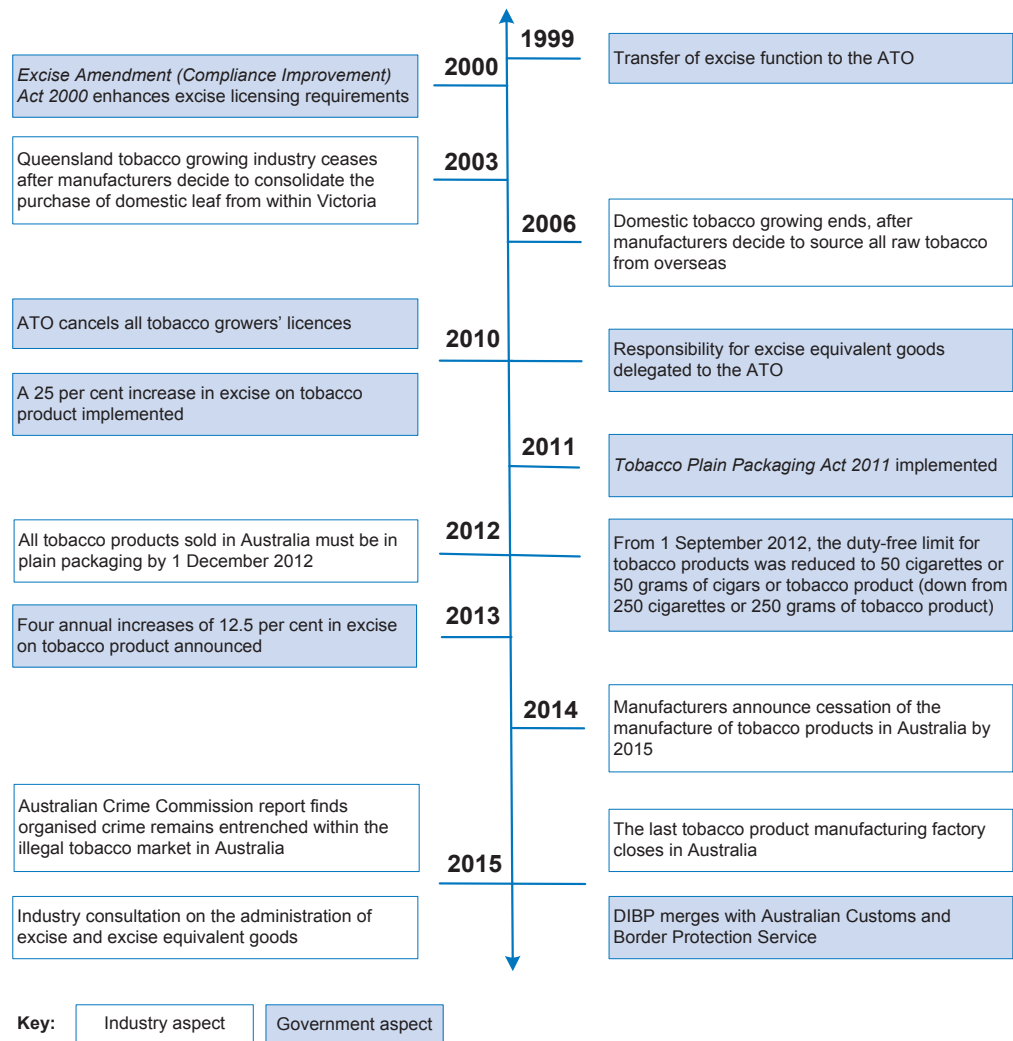
Source: ATO.¹³

Legislative, policy and commercial changes in the Australian tobacco industry

1.14 The operation, regulation and management of tobacco goods in Australia have been subject to considerable change since 1999, including the cessation of the domestic production of tobacco and tobacco products in 2015. The key changes are set out in Figure 1.3.

13 ATO website, <[https://www.ato.gov.au/business/excise-and-excise-equivalent-goods/excise-equivalent-goods-\(imports\)/which-agency-to-contact---ato-or-dibp/](https://www.ato.gov.au/business/excise-and-excise-equivalent-goods/excise-equivalent-goods-(imports)/which-agency-to-contact---ato-or-dibp/)>, accessed 7 March 2016.

Figure 1.3: Key changes in the tobacco industry in Australia



Note 1: As of 1 December 2012, under the *Tobacco Plain Packaging Act 2011* and associated regulations, retail packaging must not contain any promotional text other than brand and variant names. As a result, tobacco products not complying with the legislative requirements had to be withdrawn from the Australian retail market by 1 December 2012. These withdrawn products were to be either destroyed or exported.

Source: ANAO.

1.15 Further administrative changes may result from a DIBP review of all customs licensing regimes under the Customs Act. In November 2015, DIBP released a discussion paper seeking stakeholder input to deliver improvements in licensing arrangements ‘while ensuring the cost of maintaining the efficiency and integrity of our border is appropriately shared with those who use it’. The objectives of the review included to: assess the efficiency and effectiveness of the current licensing regimes; and recommend whether the current licensing regimes should be retained with improvements/enhancements or replaced. As part of the review DIBP welcomed comments, among other things, on: whether there is unnecessary duplication of systems and communications

between the department and the ATO for the clearance of excise equivalent goods; and whether there are inconsistencies in the treatment of excise equivalent goods and excise goods by the department and the ATO. Submissions were due by 31 December 2015.¹⁴

1.16 As at 14 March 2016, DIBP advised that submissions have been received from industry and government agencies, with some individual submissions. The department has conducted an initial assessment of the submissions, and consultations with key stakeholders are continuing.

Stakeholder engagement

1.17 Ongoing engagement with stakeholders is conducted through bi-annual meetings of the Tobacco Industry Forum. Chaired by the ATO, it involves key corporate representatives with interests in the tobacco industry, senior staff from the ATO and DIBP along with a range of government departments and industry groups, including the Australian Competition and Consumer Commission.

1.18 Key issues identified at meetings of the Tobacco Industry Forum held in the three year period 2012 to 2014 include: measures to combat the trade in illicit tobacco; reform of the excise system; and compliance activities. Feedback from industry groups on the shift of responsibilities between DIBP and the ATO was predominantly positive, but meeting minutes reflect that further reductions in compliance costs may be achieved through legislative and administrative reform in the excise and excise equivalent goods systems.

The illicit tobacco market in Australia

1.19 Trade in the illicit tobacco market in Australia is a threat to government revenue. The Australian Crime Commission report *Organised Crime in Australia 2015*, noted that 'organised crime remains entrenched within the illegal tobacco market in Australia'.¹⁵

1.20 Instances of illegal behaviour resulting in substantial loss of revenue have included:

- May 2014: approximately 350 000 mature tobacco plants were seized, with an excise value of \$15 million¹⁶;
- September 2015: the importation of considerable amounts of illicit cigarettes and tobacco was discovered, with a potential customs duty of approximately \$4.77 million¹⁷; and
- 16 October 2015: seizure of the largest ever illegal tobacco shipment, 71 tonnes, which would have avoided customs duty of approximately \$27 million.¹⁸

14 DIBP website, <<https://www.border.gov.au/ReportsandPublications/Documents/discussion-papers/review-customs-licensing-discussion-paper.pdf>>, accessed 17 November 2015.

15 Australian Crime Commission report, *Organised Crime in Australia 2015*, ACC, Canberra, pp. 68–69.

16 Australian Taxation Office 2014, *ATO rolls illegal tobacco*, media release, 4 May 2014, available from <<https://www.ato.gov.au/Media-centre/Media-releases/ATO-rolls-illegal-tobacco>>, accessed 8 January 2015.

17 The agencies were the: Australian Federal Police, New South Wales Police Force, Australian Border Force, and Australian Crime Commission. Media release, Australian Federal Police: <<http://www.afp.gov.au/media-centre/news/afp/2015/september/media-release-thirteen-charged-illegal-tobacco-importation-syndicate-shut-down>>, accessed 15 October 2015.

1.21 DIBP advised that the majority of smuggled tobacco detections occur in the sea cargo environment. The tobacco is concealed and incorrectly described as other commodities to avoid payment of customs duties. In addition, DIBP identifies risks to revenue in the international mail and air cargo environment. An exercise in 2013–14 examining mail coming into Australia, detected approximately 42 million sticks of undeclared tobacco, with an estimated customs duty evaded of over \$34 million.¹⁹

Audit objective, criteria and scope

1.22 The objective of the audit was to assess the effectiveness of the administration of tobacco excise equivalent goods.

1.23 To form a conclusion against this objective, the ANAO assessed whether:

- management arrangements between the ATO and DIBP support the effective administration of tobacco excise equivalent goods;
- ATO and DIBP systems and procedures support DIBP's collection of customs duty for tobacco excise equivalent goods; and
- compliance activities for tobacco excise equivalent goods are appropriate and effective.

1.24 The report did not explicitly cover the administration of tobacco excise, as the production of tobacco and tobacco goods in Australia ceased during 2015, and no excise revenue is expected to be collected from tobacco goods when the stocks of local produce are exhausted later this year. However, tobacco excise was covered indirectly, as there were some common arrangements with excise equivalent tobacco, such as in risk assessments. Similarly, the illicit tobacco market in Australia was not within scope, but was considered in relation to the assessment of risk and compliance activities. While the audit has focused on tobacco, there are common arrangements for the administration of other excise equivalent goods (alcohol and petroleum), and accordingly some of the findings from the audit have application for other excise equivalent goods.

1.25 In conducting the audit, the ANAO: interviewed key ATO and DIBP personnel; reviewed ATO and DIBP documents; visited ATO administered s.79 warehouses and Customs depots administered by DIBP; and conducted analysis of ATO compliance activities.

1.26 The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of approximately \$755 000.

18 Luke Rosen, 'Record haul of illegal tobacco worth \$40 million seized by Australian Border Force', ABC News, 16 October 2015: <<http://www.abc.net.au/news/2015-10-16/illegal-cigarettes-australian-border-force-record-haul/6859052>>, accessed 16 October 2015.

19 Australian Customs and Border Protection Service, *Annual Report 2013–14*, p. xi.

2. Management and reporting arrangements

Areas examined

This chapter examines management and reporting arrangements for the administration of tobacco excise equivalent goods.

Conclusion

Arrangements between the ATO and DIBP for managing tobacco excise equivalent goods and collecting customs duty have been less than effective, with weaknesses in administration and governance practices and visibility in the movement of goods. Established in 2010, arrangements under Memorandum of Understanding processes have achieved some streamlining of regulatory services to industry, but more may have been possible if the (then) Australian Customs and Border Protection Service had more fully supported and engaged with the ATO in carrying out the delegated functions.

The ATO also relies on an inadequate information technology system for the administration of tobacco excise and excise equivalent goods; and the exchange of information between the ATO's and DIBP's systems to administer excise equivalent goods is inadequate.

There is limited assurance that the correct amount of tobacco customs duty is being collected and reported, as reconciliation of goods moving through the underbond system is seldom undertaken. Further, there is uncertainty about forward estimates of tobacco revenue, as these estimates do not incorporate a change in supply and demand of dutiable tobacco arising from cheaper illicit product. As at February 2016 the ATO is developing a tax-gap estimate for tobacco that, when complete, should provide an estimate of the value of the illicit market in tobacco, and revenue foregone.

Areas for improvement

From mid-2015, there has been a renewed focus within DIBP on the joint arrangement to manage excise equivalent goods, following integration with the (then) Australian Customs and Border Protection Service; and DIBP has developed the *Tobacco Strategy 2015–18* which provides strategic direction to the department's management of the flow of tobacco across the Australian Border (both licit and illicit). The ANAO has made one recommendation aimed at improving the exchange of information between the agencies (paragraph 2.19). The ANAO also made one suggestion aimed at ensuring the operation of the management arrangement between the agencies is appropriately maintained (paragraph 2.24).

Introduction

2.1 The administration of excise equivalent goods is included in management arrangements between the ATO and DIBP relating to the administration of various taxes, namely the: goods and services tax; luxury car tax; wine equalisation tax; Tourist Refund Scheme; and excise and excise equivalent goods legislation applicable to the import and export of goods. The management arrangements consist of a:

- head Memorandum of Understanding (MoU) between the ATO and DIBP that:
 - sets out the common provisions for entering into subsidiary arrangements for the exchange of information and other activities between the agencies;

- establishes the membership and objectives of the Inter-agency Liaison Committee and the Operational Sub-Committee that manage the aspects of the relationship relating to the various taxes. The Inter-agency Liaison Committee is accountable to the Secretary of DIBP and to the Commissioner of Taxation;
- subsidiary arrangement—*Subsidiary Arrangement, Excise and Excise Equivalent Goods (EEGs)*—established under the head MoU; and
- controlled document, the *Administration of Excise Equivalent Goods—Roles and Responsibilities* (version 3, December 2013), that details the roles and responsibilities of each agency under the subsidiary arrangement (there is no document dealing specifically with tobacco goods).

2.2 Within the ATO, the administration of excisable goods and excise equivalent goods is largely conducted in the Excise Product Assurance branch (within the ATO's Indirect Tax business line). As at January 2016, the branch was structured around specific functions, for example licensing and compliance, across all commodities. During 2016, the cessation of the production of excisable tobacco goods (and the collection of tobacco excise) will result in some minor adjustments to resource allocation in the branch. Within DIBP, the Traveller, Customs and Industry Policy Division is responsible for the policy governing excise equivalent goods; and the Customs Compliance branch in the Australian Border Force coordinates and conducts border control and compliance activities.

Do the management arrangements between the ATO and DIBP support the effective administration of tobacco excise equivalent goods?

The administrative framework for managing tobacco excise equivalent goods is sound, providing detailed roles and responsibilities for the ATO and DIBP, and an appropriate committee structure. However, the (then) Australian Customs and Border Protection Service (ACBPS) did not meet the intent of the agreement by sufficiently engaging with or supporting ATO officers. Specifically, DIBP's decision not to provide ATO officers with the necessary level of access to DIBP's systems limited the ATO's ability to administer its roles and responsibilities under delegated powers for almost five years. This may have also limited the extent of the streamlining of regulatory services for industry participants, limited the effectiveness of the selection and conduct of risk and compliance activities for tobacco excise equivalent goods, and reduced the level of assurance that the correct amount of tobacco customs duty was being collected. There is no evidence that the ATO invoked dispute resolution processes set out in the head MoU between the ATO and (then) ACBPS to resolve the issue in a timely way.

From mid-2015, the newly established DIBP (following integration with the Australian Customs and Border Protection Service) has renewed engagement with the ATO to address many long standing issues related to the management of excise equivalent goods. Nevertheless, problems remain in exchanging information between the agencies, and the development of reporting mechanisms would ensure that the Secretary of DIBP and the Commissioner of Taxation are kept informed and provided assurance that the arrangement is being managed effectively.

2.3 The effectiveness of the administration of excise equivalent goods is highly dependent on cooperation between the ATO and DIBP. The head MoU includes that ‘parties will be open, honest, cooperative and responsive to each other, respecting each other’s functions and roles, and providing each other with positive assistance whenever possible’.²⁰ The subsidiary arrangement (for the administration of excise and excise equivalent goods) states that each agency is to ‘mutually assist the other to facilitate the administration of the Program’ (clause 29).

2.4 Irrespective of this requirement, a joint ATO and DIBP assessment, *Vulnerabilities in the Administration of Excise Equivalent Goods*, April 2014, identified a poor relationship between the agencies and weaknesses in almost all aspects of the functioning of the arrangement. The review identified vulnerabilities across three categories of the administration of excise equivalent goods related to: administration and governance; the visibility in the movement of the goods (including in warehoused goods); and specific legislative and technical matters, including vulnerabilities in exports.

2.5 In March 2015, the ATO prepared an update on priority issues identified from the initial review: *Gaps and Vulnerabilities Update*. The priority issues varied, with matters ranging from those that could be readily addressed by the agencies, for example the coordination of compliance activities; to systems constraints that would require significant capital investment by either or both agencies to improve functionality. An overview of the issues and their impact, focussing on key points most relevant to the administration of tobacco excise equivalent goods, is provided in Table 2.1.

2.6 Minutes of the Inter-agency Liaison Committee meetings²¹ reflected that the issues identified in the gaps and vulnerabilities documents had been raised by the ATO on several occasions, but mostly remained unresolved. Specifically, the issue of ATO staff having appropriate access to DIBP’s ICS was still outstanding as at the meeting of 16 September 2014, more than four years after the administration of excise equivalent goods was delegated to the ATO. The minutes recorded acknowledgement that an ATO officer acting under delegation should have the same system access profile as those in the (then) ACBPS doing the same function; and lack of access was inhibiting resolution of some of the vulnerabilities identified in the administration of excise equivalent goods. However, (then) ACBPS advised that ‘the ACBPS does not agree with some of the ATO views on ICS access and it has not yet received from the ATO a persuasive case for any changes to ICS access arrangements’.

20 ATO/ACBPS Head Memorandum of Understanding, 19 January 2015, clause 7, p. 8.

21 The ANAO reviewed the minutes of seven Inter-agency Liaison Committee meetings held in the period 1 July 2010 to 30 June 2015. The head MoU includes (clause 13) that the Committee is required to meet twice per year.

Table 2.1: Overview of issues relevant to administration of tobacco excise equivalent goods outlined in the *Gaps and Vulnerabilities Update*, March 2015

Priority issue	Impact
Information sharing and protocols	The exchange of information between DIBP and the ATO is ad hoc, with no formal agreed and documented processes including for: the establishment of client profiles in DIBP's ICS; and data exchange of licensing information.
Lack of coordinated compliance activities in warehouses	An entity may be able to exploit checks undertaken by both agencies by moving goods between depot and warehouse to appear compliant according to whichever agency is undertaking a check.
Handover points	There is no electronic visibility as to when responsibility for goods transfers from DIBP to the ATO.
Export vulnerabilities	The movement of excise equivalent goods underbond within the export environment provides opportunities for the diversion of these goods into home consumption. The risk of unauthorised movement, alteration or interference with export cargo is high—given that opportunities and timeframes available for examination are limited.
Restricted ATO ICS access	The time taken for DIBP to approve access to ICS for new ATO staff, and restrictions placed on ATO staff access to the system limits the ATO's ability to administer excise equivalent goods.
Licensing	Differences in warehouse licensing conditions imposed by the ATO and DIBP on the warehouses for which they are responsible affect the analysis and management of risk. There has been no systematic joint annual review of licensed warehouses since 2012 to confirm the appropriate agency has responsibility, although there has been informal liaison between the agencies.

Source: ANAO from the ATO's *Gaps and Vulnerabilities Update*.

2.7 Minutes from the Operational Sub-Committee reflected similar issues.²² The original intent was that the meetings would be held monthly, becoming less frequent as arrangements for the administration of excise equivalent goods were fully implemented. As illustrated in Table 2.2, the frequency of the meetings reduced although matters relating to the administration of excise equivalent goods remained outstanding: for example, the lack of ATO access to ICS was raised in March 2014 and again in February 2015, when there was discussion about the continuing lack of visibility by the ATO of export permissions recorded in ICS. As at January 2016, the last meeting of the Operational Sub-Committee was held in September 2015.

Table 2.2: Frequency of the Operational Sub-Committee meetings

	2010 (from August)	2011	2012	2013	2014	2015
Number of meetings	4	10	6	4	2	2

Source: ANAO from ATO minutes.

²² The ANAO reviewed the minutes of the 28 Operational Sub-committee meetings held to December 2015.

2.8 Advice from DIBP is that (then) ACBPS did not meet the expectations or intent of the arrangement with the ATO, with respect to the administration of excise equivalent goods. Irrespective of the development of detailed roles and responsibilities for each party, the (then) ACBPS and the ATO were unable to resolve issues—through the committee structure—in the governance and operation of the delegated functions for many years.

2.9 These administrative shortcomings may have limited the extent of the streamlining of regulatory services for industry participants; limited the effectiveness of the selection and conduct of risk and compliance activities for tobacco excise equivalent goods; and reduced the level of assurance that the correct amount of tobacco customs duty was being collected.

Dispute resolution

2.10 The head MoU (between the ATO and DIBP) includes (clause c3) ‘the parties must attempt to resolve any dispute concerning the Arrangement by negotiations at an operational level’ and where those negotiations fail to resolve or determine specific outcomes, the matter should be referred upwards, through the parties’ equivalent management levels, until resolved. The Terms of Reference for the Inter-agency Liaison Committee includes that the committee is accountable to the Secretary of DIBP and to the Commissioner of Taxation; and that, ‘If a matter is unable to be resolved after a reasonable period, then that matter should be referred to the Commissioner and the CEO to resolve as they consider appropriate’.

2.11 The head MoU (paragraph 4) also requires each party’s MOU manager to provide a brief annual report on the operation and progress of the agreement and subsidiary arrangements to the Inter-agency Liaison Committee. These reports have never been completed for excise equivalent goods, with the ATO and DIBP advising that the annual Certificate(s) of Assurance (prepared by the ATO for DIBP) and meetings of the Inter-agency Liaison Committee satisfied this requirement. The Certificate(s) of Assurance, however, deal only with the ATO’s acquittal of its financial responsibilities under the delegation of powers.

2.12 While the Inter-agency Liaison Committee membership includes executive staff at senior levels in each organisation, there is no evidence that concerns were escalated to the Secretary of DIBP or to the Commissioner of Taxation; and reports on the progress of the arrangement for excise equivalent goods were not prepared. As such, weaknesses in the system—which accounts for an average \$5.5 billion in revenue each year, including an average \$3.2 billion in tobacco goods—remained unresolved for almost five years.

Arrangements going forward

2.13 Minutes of the Inter-agency Liaison Committee meeting of 8 April 2015 record a more positive approach, with DIBP advising that the relevant division of the department ‘*will help ensure that the outstanding gaps and vulnerabilities are addressed, with a person allocated to each of the outstanding issues*’.²³

2.14 A joint ATO/DIBP operational level meeting to progress resolution of the gaps and vulnerabilities was held on 15 October 2015; with two ATO staff being given DIBP-level access to ICS in early November 2015, to test if this would resolve data visibility issues for the ATO. DIBP

23 The Inter-agency Liaison Committee meeting minutes, 8 April 2015, p. 4.

advised that if this is successful, this level of access will be provided to all relevant ATO staff as an interim solution, while the ATO specific profile is amended. DIBP has also developed the *Tobacco Strategy 2015–18* (dated November 2015), which provides strategic direction to the department's management of the flow of tobacco (both illicit and legally imported) across the Australian border.

2.15 The dispute resolution process set out in the terms of reference for the Inter-agency Liaison Committee, and reporting requirements included in the head MOU, were not implemented. Issues now being addressed to improve the administration of tobacco excise equivalent goods should have been resolved as they arose, rather than some five years after the delegation of powers to the ATO. Ongoing assurance that the arrangement is being managed effectively would be supported through the development of formal reporting mechanisms to the Secretary of DIBP and to the Commissioner of Taxation, following the bi-annual meetings of the Inter-agency Liaison Committee.

Information technology systems supporting the administration of excise equivalent goods

2.16 Information technology (IT) systems in both agencies are also fundamental to the administration of excise equivalent goods. All aspects of the administration of excise equivalent goods relies on information held in DIBP's ICS, but is managed on a day-to-day basis through the ATO's systems, namely the:

- Excise Collection System: a stand-alone ATO custom-built legacy system (using a Microsoft Windows 2003 platform). The system is out-dated, no longer supported by Microsoft, and has passed its decommissioning date;
- Siebel: an enterprise level system used to manage cases and work items;
- Integrated Core Processing: a new ATO system platform for many of the ATO's business processes;
- ATO Integrated System: a legacy system that is used for the ATO's accounting and transactional processes; and
- Data Warehouse: the central repository of integrated data sourced from multiple systems.

An overview of the arrangement is shown in Figure 2.1.

2.17 The IT arrangement is complex and unwieldy. There is a lack of direct system interfaces supporting the information exchange between DIBP's ICS and the ATO's Excise Collection System; and between the ATO's various systems. The arrangement relies heavily on manual intervention, including data entry (at times including double entry into multiple systems), and email correspondence to maintain the accuracy and currency of information. For example, the creation of an establishment code in ICS (for licensing purposes) requires an email exchange between an ATO licensing officer and a DIBP officer, and manual updates to computer systems in both agencies.²⁴

2.18 The arrangement has developed with the transfer of the administration of excise equivalent goods to the ATO, aimed to streamline services to taxpayers. However, taxpayers still have to engage with both agencies, and the data exchange 'loop' through the ATO to DIBP's ICS is far from efficient. The situation has been further exacerbated by DIBP's reluctance in the first five years of the arrangement to provide ATO officers (effectively acting as DIBP or 'customs officers' under the delegated powers), the necessary access to ICS (as discussed earlier in this paper).

Recommendation No.1

2.19 To support the administration of excise equivalent goods, the ANAO recommends that:

- (a) the ATO reviews and, subject to competing information technology priorities, improves the information technology platform currently in use; and
- (b) DIBP and the ATO improve the exchange of information between the respective agencies.

ATO response: *Agreed.*

2.20 *The ATO supports this recommendation. Our Reinvention Program has examined the excise system in use. Improvement opportunities have been identified and are being considered as part of our planning and prioritisation processes. The ATO is piloting additional access recently granted by DIBP to its Integrated Cargo System.*

DIBP response: *Agreed.*

2.21 *The Department supports this recommendation and is progressing the work necessary to provide the following to the ATO:*

- (a) *Additional data fields in the automated nightly data upload to the ATO systems.*
- (b) *An interim solution for increased Integrated Cargo System access while system changes are developed in the longer term to increase the level of visibility within the system for delegated officers within the ATO.*
- (c) *A greater level of ad hoc information exchange through a closer working relationship, particularly in the joint operational space.*

24 The ATO's Excise Collection System was included in the ANAO's financial statement audit, at Appendix 2.

Is the correct amount of customs duty collected and reported?

There is no calculation or reconciliation that provides assurance that the correct amount of customs duty is being collected and reported:

- neither the ATO nor DIBP examines the value of the charges due from the physical quantities of imported tobacco goods moved into the underbond system, and the actual volume of these goods (and customs duty paid) reported entering the domestic market;
- revenue (excise and customs duty) collected from tobacco goods is reported in Australian Government Budget documents, against forward estimates based on projected consumption (that include assumptions about fluctuations in demand, for example due to increases in excise rates). The assumptions do not factor in the size of the illicit trade in tobacco and potential changes to the supply of and demand for dutiable goods as a result of the increase in costs in the legitimate market; and
- the size of the trade in illicit tobacco (and value of revenue lost) has been the subject of much analysis, but the various results have not been agreed by key government and industry stakeholders. As at February 2016, the ATO was developing a tax-gap estimate for tobacco that will provide an estimate of the value of the illicit tobacco market and resultant revenue foregone.

2.22 The ATO is responsible for the collection and reporting of excise, and DIBP for customs duty. The ATO provides a monthly *Financial Summary Reconciliation Report* to DIBP on the revenue collected on DIBP's behalf (not specific to commodity).²⁵ DIBP could not provide any information on how, or whether, the report is used. DIBP provides the ATO with its monthly (so-called) 'alcopops'²⁶ report, which includes data on the quantity and duty value for excise equivalent goods extracted from the ICS for each commodity, with the ATO advising that the agency has little or no use for the report.

Reconciliation of excise equivalent goods underbond

2.23 Effective control of the warehousing and movement of excise equivalent goods ensures there is no 'leakage' of goods and avoidance of customs duty, through for example: theft from a warehouse or when the goods are in transit; damaged goods not being destroyed; or goods being moved into the illicit market. Warehouse operators are liable for the payment of customs duty on goods that cannot be accounted for, and the ATO advised that the risk of 'leakage' is limited to smaller operators whose warehouses are not equipped with technology to track the movement of all goods. There are also constraints in the wording of licences that limit the identification of goods stored in some s.79 warehouses administered by the ATO, further discussed in Chapter 3.

2.24 Irrespective of the goods tracking systems in larger warehouses, with regard to excise equivalent goods, there are weaknesses in the agencies' capacity to: control the movement of

25 The ATO collects some Customs duty and related charges for DIBP. In 2014–15, receipts (in relation to all commodity types) included \$1.126 million from customs licence fees, \$260 401 from customs duty (debt) and \$50 000 from security deposits.

26 The name of this report is a legacy from when it was originally generated to report on the former 'alcopops' tax, introduced in 2008 to curb teenage binge drinking. DIBP has stated that the report is now focused on excise equivalent goods.

excise equivalent goods (identified in the ‘gaps and vulnerabilities’ document); and to reconcile the volume of goods recorded in N20 Declarations (when excise equivalent goods enter a warehouse) and N30 Declarations (when excise equivalent goods are released into home consumption). The gaps and vulnerabilities document identified that monitoring and analysis capability for the purposes of risk assessment and targeting was undermined because of the inability to cross match events pertaining to the movement of cargo.

2.25 The ATO advised²⁷ that a reconciliation (of N20s and N30s) is technically possible, but is resource intensive (requiring a physical stocktake of goods located in a warehouse), and seldom done. Essentially, the operation of the underbond system, where goods may be moved between several licensed warehouses, the deferment of customs duty until the goods are released into home consumption, and tracking of goods that may be damaged and customs duty is not payable, makes regular and accurate reconciliation of goods through the underbond system difficult to achieve. Irrespective of these difficulties, the absence of such reconciliations limits the effectiveness of risk and compliance activities, further discussed in Chapter 4.

Actual and forecast tobacco revenue

External reporting

2.26 Neither the ATO nor DIBP include in their annual reports, the amount of excise or customs duty collected by commodity—each agency reports the combined amount of revenue (that is excise or customs duty respectively) associated with petroleum, alcohol and tobacco excisable goods and excise equivalent goods.²⁸ Similarly, there is no reference in either agency’s Corporate Plan to responsibilities or prospective revenue in relation to excise or customs duty.²⁹

2.27 Commencing in 2013–14, revenue raised from tobacco goods (combined excise and customs duty) is reported in Australian Government Budget documents.³⁰ The Budget Papers report the tobacco revenue outcome for the most recent completed year, an estimate for the current year, forecasts for the next two years and projections for a further two years. Actual and forecast revenue for the six year period 2013–14 to 2018–19 is set out in Figure 2.2.

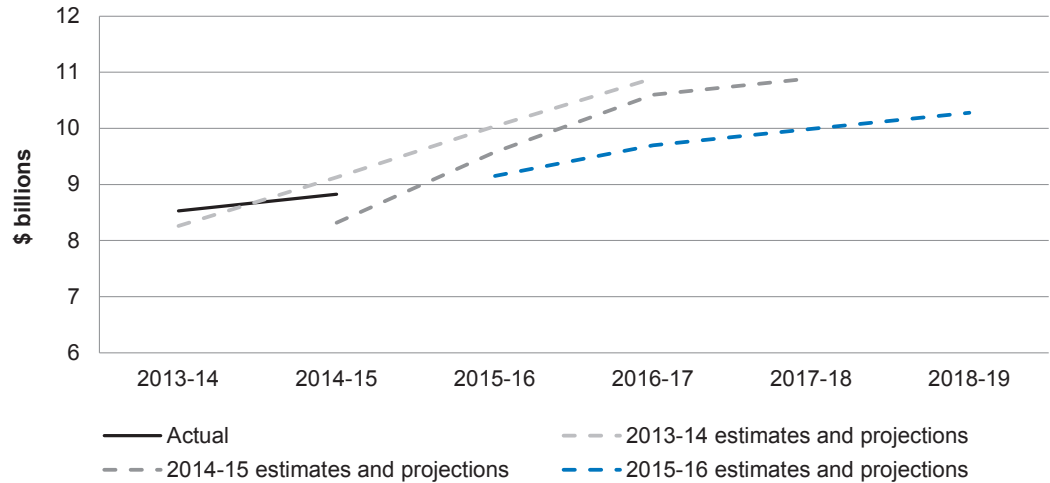
27 ATO document prepared for the ANAO: Nature 20/Nature 30 Reconciliation, August 2015.

28 In 2012–13, the ATO’s *Taxation statistics* reported the volume of tobacco product and number of cigarettes produced, as well as the excise liabilities raised, from 2003–04 to 2013–14. Available from the ATO web-site <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-statistics/Taxation-statistics-2012-13/?anchor=Taxationstatistics201112tables#Taxationstatistics201112tables>>. [Accessed 11 February 2016].

29 The ANAO reviewed the: ATO Annual Reports, 2010–11 to 2014–15; ACBPS Annual Report 2014–15; ATO Corporate Plan, 2014–18 and 2015–19; and DIBP Corporate Plan 2015–19.

30 The 2013–14 Final Budget Outcome was the first time an aggregate outcome for tobacco excise and customs duty revenue was published. Prior to 2012–13, the revenue from tobacco excise only was reported separately, with the customs duty for tobacco part of an aggregate amount including duty on fuel and alcohol excise equivalent goods. The 2013–14 Mid-Year Economic and Fiscal Outlook was the first Budget document that reported forecasts for tobacco excise and duty together as a single amount, although the 2012–13 revenue outcome could not be published because of taxpayer confidentiality. Subsequent legislation allowed the publication of aggregate tax information regardless of the number of taxpayers.

Figure 2.2: Actual and forecast tobacco revenue, 2013–14 to 2018–19



Source: ANAO, from Australian Government Mid-Year Economic and Fiscal Outlook statements, 2013-14 to 2015-16.

2.28 Revenue forecasts are based on estimates of the consumption of legitimate tobacco products, which allow for assumptions about fluctuations in demand due to policy changes, such as increases in excise rates. The current revenue forward estimates reflect a slower rate of growth in revenue, as increased excise rates are off-set by a reduction in demand. The forecasts do not allow for changes in the supply of and demand for illicit tobacco, as the price (of the legitimate product) increases.

Estimating the tobacco excise tax gap

2.29 The ATO has publicly committed to estimating the tax gap for all the taxes it administers.³¹ A ‘tax gap’ is defined as the difference between the estimate of tax theoretically payable (assuming full compliance by all taxpayers) and the amount actually reported or collected for a defined period. A tax gap can result from actions that are deliberate, careless or unintentional. From 2012, the ATO has published tax gap estimates relating to the goods and services tax and the luxury car tax.

2.30 In 2014–15, the ATO released tax gap estimates for: the wine equalisation tax; excise and customs duty (for petroleum, diesel, and beer); ‘pay as you go’ withholding; and fuel tax credits; and, as at 25 August 2015, has refreshed the estimates for the goods and services tax and luxury car tax. As at February 2016, the ATO advised that it is developing a tax gap analysis for tobacco, with DIBP seeking executive endorsement to progress the work jointly with the ATO. The inter-departmental team would explore multiple ways to measure the size of the illicit tobacco market—with a subsequent conversion to an excise and customs duty amount. Subject to its credibility and reliability, the ATO intends to release a tax gap estimate for tobacco in its 2015–16 annual report.

31 The tax gap estimates ‘form part of a suite of high level measures that track the performance and integrity of the tax system’. The ATO intends that, over time, this information will complement its existing key performance indicators. <<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Measuring-tax-gaps-in-Australia,-2014-15/>> [Accessed 3 December 2015].

3. Licensing s.79 warehouses administered by the ATO

Areas examined

This chapter examines the arrangements for issuing and renewing licences to operate s.79 warehouses administered by the ATO, which can store (among other excise equivalent goods) excise equivalent tobacco.

Conclusion

The licensing regime for s.79 warehouses administered by the ATO could be improved. The ATO has developed little specific guidance and process documentation, instead applying existing excise guidance to s.79 warehouses under its administration. The ATO has recently amended the wording on licences to clearly identify the goods that can be stored in a warehouse, but there is scope to improve other aspects of the processing of licence applications and renewals.

Areas for improvement

To support the administration of the licensing regime for s.79 warehouses administered by the ATO, the ANAO has recommended that the ATO develops specific guidelines and procedural documentation for the warehousing of excise equivalent goods (paragraph 3.5). The ANAO has also suggested that the ATO: assesses the results of its revised policy to not conduct criminal history checks of new employees of large companies (paragraph 3.16); ensures that a new checklist covers all legislative and policy requirements for issuing a warehouse license (paragraph 3.19); and reviews the extent of quality assurance checking in relation to licensing (paragraph 3.27).

Has the ATO developed procedural guidance for the licensing of s.79 warehouses?

The ATO has applied excise licence policy and process to excise equivalent licences, although the licences are issued under different legislation—the *Excise Act 1901* and the *Customs Act 1901* respectively, and no analysis of the requirements of the Acts has been conducted. With regard to tobacco, the ATO has focused on the administration of excisable goods, although the cessation of the tobacco industry in Australia (and a corresponding increase in revenue from customs duty) has been foreshadowed for several years. The ATO could have been more active in its administration of licensing for s.79 warehouses under its administration.

3.1 The requirement for industry to apply for and to renew licences for premises where excise and excise equivalent goods may be manufactured and/or stored is an important regulatory mechanism in the administration of these goods.³² In 2009, in a policy review of licensing decisions, the ATO described licensing as a cornerstone of the regulation of excise products. All applications for a licence, or to renew a licence to manufacture and/or store excise and excise

32 As at January 2016, licences for premises to manufacture and/or store excise goods were renewed every three years with no licence fee. Licences for s.79 warehouses administered by the ATO are renewed annually: the licence fee is \$7000 for a new client and \$4000 for a renewal.

equivalent goods, are managed by the licensing team within the ATO's Indirect Tax business line, utilising the ATO's Excise Collection System and DIBP's ICS. As previously illustrated in Figure 2.1, the exchange of data between the ATO's and DIBP's systems for licences issued under the Customs Act is not streamlined, relies on manual input, and was identified as a weakness, among other aspects of the administration of these licences, in the gaps and vulnerabilities documents.

3.2 As at 1 December 2015, the ATO administered a total of 1682 licences related to the manufacture and/or storage of excisable goods held by 895 clients; and 324 licences for ATO administered s.79 warehouses to store excise equivalent goods, held by 155 clients. The licences are issued under different Acts, the Excise Act and the Customs Act respectively, and have different application forms and licences.

3.3 The ATO provided a number of Excise Practice Notes³³ dealing with the licensing process and the issuing of movement permissions (relating to the movement of excisable goods). There were no similar documents dealing with the administration of licences for s.79 warehouses administered by the ATO; and there is no reference or additional notes (relating to s.79 warehouses or excise equivalent goods) in any of the excise related documents provided.

3.4 The ATO advised that: in the absence of specific licensing guidance from DIBP, the same or similar approach is applied to all licenses, as they consider the core criteria is essentially the same (for excise and excise equivalent goods). However, the excise and excise equivalent goods systems are administered under different Acts, and there was no evidence that the ATO had analysed the requirements under each Act to support the decision to apply common procedures to both licensing regimes. The cessation of excise tobacco in Australia adds further impetus for the development of guidance and procedural documentation for the warehousing of excise equivalent goods, including engagement with DIBP to improve the process.

Recommendation No.2

3.5 To support the issuing and renewal of licences for operators of s.79 warehouses administered by the ATO, the ANAO recommends that the ATO develops specific guidelines and procedural documentation for the administration of s.79 warehouses under ATO control.

ATO response: *Agreed.*

3.6 *The ATO supports this recommendation. Our Practice Notes are currently being reviewed to strengthen this aspect.*

DIBP response: *Agreed.*

3.7 *The Department supports this recommendation and will provide the ATO with the required support and advice as the ATO develops the recommended framework.*

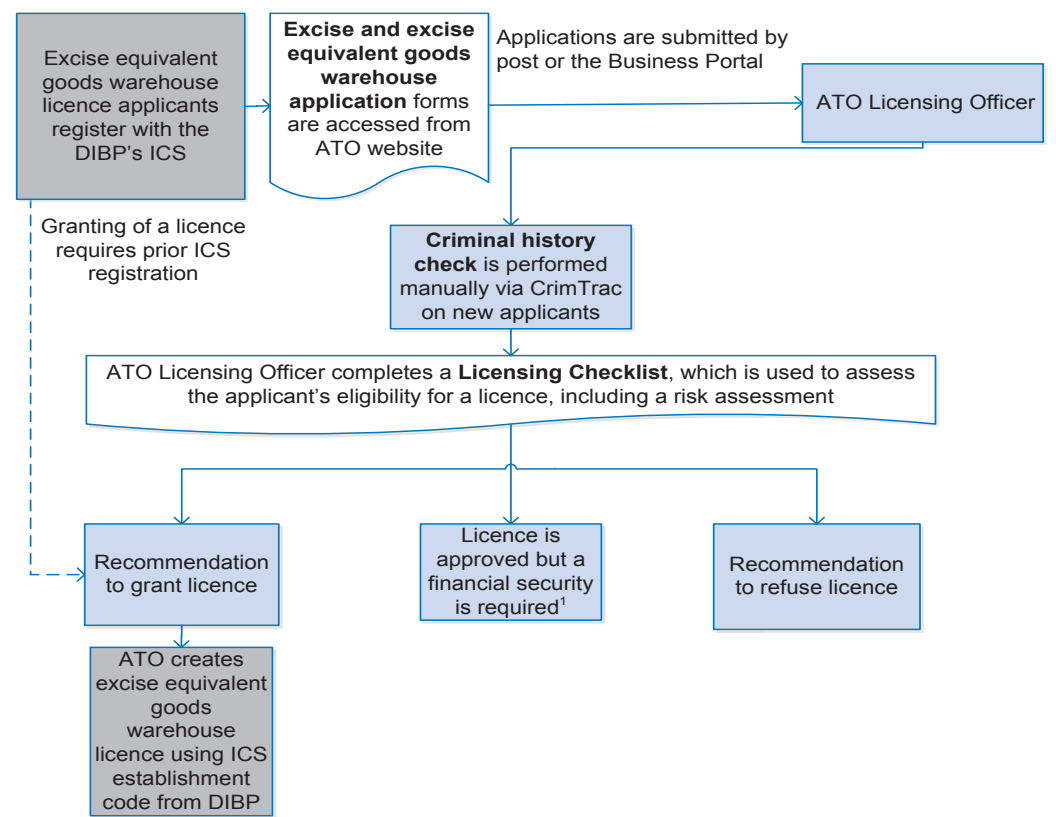
33 The ATO Excise Practice Notes provided were: *Excise Practice Note 2014/02–Excise Licensing*; *Excise Practice Note 2014/01–Excise Practice Note System*; *Excise Practice Note 2015/05–Excise Licence Conditions*; *Excise Practice Note 2015/03–Unfavourable Licensing Decisions*; *Excise Practice Note 2015/02–Movement Permissions*; and *Excise Practice Note 2015/01–Excise Licensing–Considering and Licensing the Correct Entity*.

Is the process effective for issuing and renewing s.79 warehouse licences administered by the ATO?

The process for issuing and renewing a licence to operate a s.79 warehouse administered by the ATO could be improved. The ATO has changed the wording on licences to more clearly identify the goods that may be stored in a warehouse, and is developing a new checklist for the application process, but more could be done. The number of criminal history checks on licence applicants has been reduced, but the ATO has not analysed the impact of this on incidences of non-compliance.

3.8 The ATO’s licensing process for s.79 warehouses, as at November 2015, is set out in Figure 3.1.

Figure 3.1: Licensing process for s.79 warehouses administered by the ATO, as at November 2015



Note 1: Warehouses assessed as at higher risk (of non-compliance), or applicants applying for their first warehouse license, may be required to provide a financial security bond.

Source: ANAO, based on information provided by the ATO.

3.9 The ANAO examined four elements of the process: the conduct of criminal history checks; the use of process checklists; recording of licence application decisions; and the wording in licences. The ANAO also examined the ATO’s quality assurance processes for licensing decisions.

Conducting criminal history checks

3.10 Prior to July 2009, the ATO routinely conducted criminal history checks on all applicants for a licence to manufacture and/or store excisable goods, in assessing if the applicant (or an associate) was a 'fit and proper person' to hold a licence.³⁴ Between December 2006 and July 2009, the ATO conducted over 800 criminal history checks. From January 2011 to November 2015, the ATO completed a total of 158 criminal history checks for licence applications for s.79 warehouses under its control.

3.11 Since 2009, the ATO has made several changes to the policy for conducting criminal history checks, set out in Table 3.1.

3.12 The ATO provided two policy documents relating to these changes: in July 2009 and in December 2013.

Policy change, July 2009

3.13 An ATO minute, *Use of Criminal History Record Checking in Licensing Decisions*, 6 July 2009, provides the rationale for moving to a risk based approach for the conduct of these checks, based on the premise that:

- since December 2006, over 800 CrimTrac searches had been undertaken, with 53 individuals found to have a criminal history, but none of the checks had resulted in the refusal to grant or to cancel a licence. Anecdotal information indicated that in the two years, the results of a CrimTrac check did not influence a licensing decision; and
- the cost of CrimTrac searches had been over \$18 000 since 2006 (around \$23 per check). Direct administration of the process accounted for approximately 0.15 full time equivalent staff, with additional 'large amounts of extra time spent by licensing officers on obtaining forms and appropriate POI [proof of identity] from clients before CrimTrac checks can be lodged', adding to the regulatory burden to applicants, and some delay in processing the licence application.

The document also notes the deterrent effect of asking applicants or their associates to complete a *Consent to obtain information* form, and that the practice should continue as it 'provides Licensing with some insight about the applicant (albeit self-assessed) and is a low cost to the client and Licensing'.³⁵

Policy change, December 2013

3.14 The December 2013 policy document provided to the ANAO, *Excise Act Policy—Requirement to Undertake Criminal History Checks*, is not on an official form, is undated and does not refer to any authorising or responsible officer.

34 The Excise Act defines 'fit and proper' person with regard to whether an applicant has: been charged with an offence within a year before the application was made; been convicted of an offence 10 years before the application was made; held or co-managed a company that has had its licence cancelled; been non-compliant within four years before the application was made; insufficient financial resources or is an undischarged bankrupt; or made any misleading or false statements.

35 ATO: *Use of Criminal History Record Checking in Licensing Decisions*, 6 July 2009, p. 3.

Table 3.1: ATO policy for criminal history checks in the licensing process

Year	Licences for warehouses for excisable goods	Licences for s.79 warehouses administered by the ATO
Pre-July 2009	Criminal history checks conducted on all applicants.	N/A
2009	Excise policy document implemented, changes include criminal history checks conducted on a risk-based framework.	N/A
2010	As above.	Due to a lack of guidance from DIBP, ATO adapted the excise criminal history check policy to excise equivalent goods warehouse licences. Criminal history checks were carried out on <u>all</u> new excise equivalent goods licence applicants while existing licence holders were checked on a risk basis.
2013	The 2009 excise policy document was updated. Criminal history checks included the following exemptions: low risk industries and government applicants.	The criminal check process for excise equivalent goods licences remained. While the updated excise policy did not formally apply to excise equivalent goods licence applications, it was still used as a basis for existing licence holders.
November 2013	As above.	In November 2013, new legislation was introduced that included additional criteria for fit and proper checks. The changes meant that criminal history checks and aviation or maritime security identification card checks had to be carried out on all <u>new</u> applicants. Existing licence holders remained checked on a risk basis.
2015	The existing policy on criminal history checks for excise licence applications was withdrawn and all checks were carried out on a risk assessed basis, irrespective of whether the applicant was new to excise or an existing licence holder.	As above.

Source: ANAO analysis of ATO documents. Table developed in cooperation with the ATO.

3.15 The ATO advised that the policy applies to *fit and proper person* checks undertaken under the Excise Act, and has been adopted for excise equivalent goods. The policy provides a list of exemptions for the further conduct of criminal history checks, limiting the checks to entities identified as a 'high risk' (though no criteria for this risk are included in the document).³⁶

³⁶ Where a client or industry is not assessed as a 'high risk', criminal history checks should not be carried out if any of the following exemptions apply: large entities—a tobacco entity with a duty liability greater than \$1 billion; any government applicant; any tertiary education institution; existing licence holder with new staff; existing licence holder seeking a new type of licence; and overseas company directors.

The policy also negated the need for entities exempt from a criminal history check to complete *Consent to obtain information* forms.³⁷

3.16 The new policy significantly reduces the number of criminal history checks carried out, specifically for large entities, and negates any deterrent effect of the requirement to complete a consent form. The ATO advised that the criminal history checks have been reduced for large entities as those entities conduct their own criminal history checks. However, there was no advice available as to how the ATO verifies that these checks are being conducted. In this light, the ATO could assess the results of this change in the policy for conducting criminal history checks, including considering any increase in the incidence of warehouse operators' non-compliance with the requirements of their licence.

Developing a new checklist for processing warehouse licence applications

3.17 In September 2015, the ATO commenced a limited trial of a new checklist to support the processing of applications for all licensed warehouses under its control. Subject to the trial, when fully developed and implemented, the new checklist is intended to replace the separate excise/excise equivalent checklists currently in use (irrespective of the commodity or commodities to be stored). The checklists include consideration of the: physical security of the warehouse, for example the adequacy of security measures; value of goods to be stored; and insurance held by the applicant (for loss or damage to the stored goods). The new (combined) checklist requires more detailed responses, with officers providing written comments against specific 'checks'—rather than the previous 'yes' or 'no' response with optional comments—and a written evaluation of the decision.

3.18 The checklist being trialled also reflects legislative changes to the warehouse licensing regime, (including for s.79 warehouses administered by the ATO) introduced by the (then) ACBPS in February 2014.³⁸ The changes are outlined in Table 3.2.

37 In conducting 'fit and proper person' checks as part of warehouse license processes, the ATO may check company directors, officers, shareholders, managers or supervisors, and employees. ATO website <https://www.ato.gov.au/forms/customs-warehouse-licence-application/?page=5#How_we_assess_your_application>, accessed 8 March 2016.

38 *Customs and AusCheck Legislation Amendment (Organised Crime and Other Measures) Act 2013*.

Table 3.2: Legislative changes to the warehouse licensing regime, February 2014

Amendments to the <i>Customs Act 1901</i>	What the changes mean
Additional criteria for 'fit and proper person' tests.	The Secretary of DIBP, or the delegate, must now consider whether a person has been refused an aviation or maritime security identification card or had it suspended or cancelled in the previous 10 years.
Additional notification requirements for a warehouse licence holder.	Holders of a warehouse licence must notify the Secretary of DIBP, or delegate, where the licence holder or partners have had an aviation or maritime security identification card refused or cancelled, within 30 days.

Source: Australian Border Force.

3.19 The ATO advised that these requirements were implemented but, as at December 2015, they are not reflected in the checklist currently in use for s.79 warehouses administered by the ATO; and the ATO was unable to advise how compliance with the additional notifications for licence holders was verified. The ATO subsequently provided an updated version of the (combined) checklist (updated 28 January 2016) reflecting that checking the status of an applicant's maritime or aviation security card should be undertaken on a risk assessed basis (but did not provide information on relevant risk criteria). The ATO could ensure that the new checklist, including the recent update on the status of maritime or aviation security cards, meets all legislative and policy requirements for issuing a license.

Recording licence application decisions and renewals

3.20 The ATO maintains a record of new warehouse licences for excise and excise equivalent goods granted each year (including those that are required to pay a security deposit). Where a licence application is refused, the ATO must provide the applicant with the reason for the refusal, including that the decision can be appealed.

3.21 Since 2010, the ATO has not refused any applications for a s.79 warehouse licence and has requested 111 security deposits. A number of these security deposits were to replace those previously held by DIBP prior to the change in administration, and some have since been returned. Over the same period, there has been one appeal of a decision to the Administrative Appeals Tribunal that was not in relation to granting or refusing a s.79 licence but to a variation of licence conditions.

3.22 For annual s.79 warehouse licence renewals, the ATO sends licence holders a notification six weeks prior to expiration of their licence. In most cases, once payment is received by the ATO, the licence is renewed. The ATO advised that there are a number of instances where a renewal application will undergo a review, for example: where compliance issues have been identified; there has been a change of key warehouse staff members; or the licence holder is selling the business. The ATO could not provide advice on how many renewal applications had been reviewed and the outcome of the reviews.

Changing the wording in licences for s.79 warehouses administered by the ATO

3.23 In 2010, the ATO identified an anomaly in the wording of s.79 warehouse licences when the administration of these licences was transferred from the (then) ACBPS. Ambiguity in the wording of the licences meant the ATO could not readily identify the type(s) of excise equivalent

goods that could be stored in s.79 warehouses under its administration, as shown in Table 3.3, and has taken steps to amend the wording.

Table 3.3: Wording of licences for s.79 warehouses administered by the ATO

Previous wording on a licence to store tobacco excise equivalent goods	New wording on a licence to store tobacco excise equivalent goods
Goods subject to Customs control excluding petroleum and like products.	Goods subject to Customs control being tobacco and tobacco products.

Source: ANAO from ATO documents.

3.24 Effectively, the warehouse licence holder for tobacco goods could store both alcohol and tobacco products. The ATO changed the wording for all new licences issued from 2010, but did not apply this change to licence renewals until November 2015. As licences are renewed, licence holders are now required to complete a stocktake of the goods stored in the warehouse, and the ATO determines that the licence is appropriate and the wording on the licence specifies the goods that can be stored.

3.25 Over a 12 month period (as licences are annually renewed), the ATO is to establish an accurate list of the type of goods that warehouse licence holders are permitted to store, providing essential information for compliance purposes. Until this is completed, the ATO has limited visibility of the types of goods licence holders are permitted to store in s.79 warehouses that it administers.

Conducting quality assurance on licensing decisions

3.26 The ATO's licensing process requires that the recommendation (to grant or refuse a license) of the officer assessing a new licence application must be reviewed and approved or disallowed by a more senior delegate (this instruction is included in the new licensing checklist being trialled). Commencing in the December 2014 quarter, licensing decisions were included in the ATO's corporate quality assurance process, the ATO Quality Model, as applied in the Indirect Tax business line.

3.27 A review of the four quarterly reports on the quality assurance testing in the Indirect Tax business line, between December 2014 and September 2015, showed that licensing decisions were not always specifically considered, but opportunities for improvement were identified. For example, scope to improve recordkeeping processes were identified to provide clear reasons behind a decision, and to improve licensing processes cases were subsequently moved to a new case management system. The ATO advised that there was no distinction between excise and excise equivalent goods licence cases examined in the quarterly reports, and the QA process was not applied to license renewals. The ATO could review the extent of its quality assurance activities in relation to licensing, to ensure that an appropriate level of assurance is provided.

4. Risk and compliance

Areas examined

This chapter examines the ATO's and DIBP's management of the risk associated with tobacco industry participants' non-compliance with their obligations in relation to excise equivalent goods and customs duty liabilities, and the ATO's and DIBP's conduct of compliance activities.

Conclusion

The risk associated with the administration of tobacco excise equivalent goods has not been consistently assessed over the previous five years, with no clear rationale for the fluctuation in annual risk ratings. The ATO and DIBP could more effectively work together to analyse factors influencing risk.

The planning and conduct of compliance activities for tobacco excise equivalent goods stored in s.79 warehouse administered by the ATO could be improved, including by greater engagement with DIBP. Within the ATO, there is a lack of process for selecting warehouses for targeted compliance activities, and the recording of completed compliance activities could be improved.

Area for improvement

The ANAO made two recommendations aimed at improving the assessment of risk that would subsequently support more effective selection and targeting of compliance activities (paragraphs 4.13 and 4.34).

Are risks associated with tobacco excise equivalent goods effectively assessed?

Risks associated with the administration of tobacco excise equivalent goods have not been consistently assessed. Fluctuations in the annual risk rating (from 'low' to 'moderate' to 'significant') lacked a clear rationale, with the most recent rating based on reputational risk to the ATO and DIBP. The shared administration of this risk between the ATO and (then) Australian Customs and Border Protection Service has been ad hoc and informal. There has been little evidence that the expectations of the relationship have been met regarding access to and the timely exchange of: knowledge and expertise of risk staff; and risk-related information, both ongoing and as part of the annual risk management process within each agency.

4.1 Customs duty is calculated and collected under a self-assessment regime, where industry participants are expected to comply with the laws and regulations regarding the importation and sale of excise equivalent goods, and to pay their customs duty liabilities. Assessment of the risk of taxpayers' non-compliance and targeted compliance activities aim to provide assurance that taxpayers are meeting their obligations.

4.2 The *Subsidiary Arrangement—Excise and Excise Equivalent Goods*, between the ATO and DIBP specifies that: the ATO and the (then) ACBPS have joint responsibility for the risk management of excise equivalent goods; each party will manage risks in accordance with their risk management policies; and where there is a need to jointly manage risk, it will be managed through the Operational Sub-Committee, and in accordance with the *Excise Equivalent Goods—Roles and Responsibilities* document. The ATO identifies the administration of excise equivalent

tobacco products as a shared responsibility in its risk assessments. A summary of each agency's key responsibilities related to risk and compliance is set out in Table 4.1.

Table 4.1: Summary of agencies' key responsibilities relating to risk and compliance for excise equivalent goods

Risk responsibilities	
ATO	DIBP, (then) ACBPS
Revenue risks associated with: entities that operate warehouses storing excise equivalent goods; or import or own excise equivalent goods that are imported.	Border risks for all goods; and risks relating to transactions where excise equivalent goods are imported and delivered directly into home consumption.
The control of activities of ATO administered warehouses; authorising the movement of excise equivalent goods; and post transaction reconciliation of Nature 20 and Nature 30 declarations.	Pre-clearance intervention in all cases; and post-transaction verification of Nature 10 import declarations for excise equivalent goods (regardless of whether the importer also imports and warehouses excise equivalent goods).
Strategies for working together	
<ul style="list-style-type: none"> • The Operational Sub-Committee will oversee the excise equivalent goods risk management framework. • The ATO and (then) ACBPS will exchange a list of entities with prospective compliance activities planned. The plans will be submitted annually, with periodic updates as required. • The ATO will work with the (then) ACBPS to ensure that there is an ongoing exchange of knowledge and expertise for risk staff. • Each agency will ensure there continues to be a timely exchange of risk related information; and the agencies will consult with each other as part of that annual risk management process. • Both agencies will ensure there is an ongoing exchange of information and intelligence. 	
Compliance activities	
ATO	DIBP, (then) ACBPS
Compliance activities associated with ATO administered warehouses and importers / owners of warehoused excise equivalent goods including: <ul style="list-style-type: none"> • warehouse checks for compliance with warehouse obligations; • audits of importers' and owners' excise equivalent goods warehousing transactions; • issue of demands and collection of duty; and • control of goods including movement without authority. 	Pre-clearance intervention for all import and export transactions; and post transaction verification activities for Nature 10 transactions for excise equivalent goods (regardless of whether the importer also imports and warehouses excise equivalent goods) and for exports of excise equivalent goods.

Source: ATO and (then) ACBPS, *Administration of EEG Roles and Responsibilities*, December 2013.

4.3 Irrespective of the responsibilities of each agency, the shared administration of risk and compliance associated with tobacco excise equivalent goods has been ad hoc and informal, with little evidence that the expectations set out in the roles and responsibilities document have been met. Essentially, the ATO has assessed the risk and conducted compliance activities in the absence of any oversight or engagement by the (then) ACBPS. Issues concerning the management of risk and compliance were identified in the 'gaps and vulnerabilities' documents (previously discussed),

including: constraints on the ATO's targeting of compliance activities due to limited access to DIBP's ICS and the client information stored in that system; and there is no evidence of an excise equivalent goods risk management framework.

4.4 More broadly, in its annual financial audit of DIBP for 2014–15, the ANAO identified weaknesses in the governance and management oversight of (then) ACBPS' customs duty compliance program. The audit findings are at Appendix 2.

The ATO's assessment of risk associated with tobacco excise equivalent goods

4.5 Risk assessments for tobacco excise equivalent goods involve four groups of risk participants: licence holders; importers; contracted transport companies that move tobacco goods underbond but are not regulated by either the ATO or DIBP; and advisers and registered agents (for example, customs brokers) that have administrative control of the goods. Trade in the illicit market (with high profits to be made through criminal activity that avoids payment of customs duty on tobacco products), puts added pressure on legitimate traders operating within the underbond system.

4.6 The ATO has typically assessed that this risk is mitigated by the profile of the tobacco industry in Australia. An oligopoly, the industry is dominated by four large companies involved in the manufacture (until 2015) and/or import of tobacco and tobacco products. Identified as 'key taxpayers'³⁹ by the ATO, these companies account for 98 to 99 per cent of the (combined) total of tobacco excise and customs duty collected per year, and are assessed as low risk of non-compliance with their excise and customs duty obligations. Similarly, two large service industries providing warehousing and logistics to the industry, while not categorised as 'key taxpayers', have been assessed by the ATO in 2014–15 for goods and services tax and (in one case) excise, and categorised as lower risk (of non-compliance) taxpayers.

4.7 The ATO provided six key documents related to the assessment of risk associated with tobacco excise and excise equivalent goods, developed between 2011 and 2015. For tobacco, the ATO's overarching risk is 'failure to ensure taxpayers understand and meet their excise and excise equivalent goods obligations for tobacco products'. The documents are summarised in Table 4.2.

39 Entities identified as 'key taxpayers' are large businesses where the consequence of non-compliance with their tax obligations would be high, but the likelihood of non-compliance is low. The ATO applies a 'light touch' to these companies' compliance matters, and engages with them through designated relationship managers. ATO website <<https://www.ato.gov.au/general/building-confidence/public-and-international-groups/transparency/how-we-assess-and-manage-risk/>>. [Accessed 8 December 2015].

Table 4.2: Summary of the ATO's tobacco risk assessments and reviews, 2011–12 to 2014–15

Year	Risk rating
Risk review: Excise Equivalent Goods, August 2011	Moderate The review summary includes all excise equivalent commodities (not solely tobacco) and excludes all excise commodities.
Tobacco Risk Assessment November 2012	Moderate The tobacco risk was set at 'Moderate' for the duration of the Plain Packaging Destruction program. The Tobacco industry is made up of four large entities, which account for 99 per cent of tobacco revenue.
Overall EEG Risk Assessment, June 2013	Low The overall risk for excise equivalent goods was reduced to 'Low' after extracting excise equivalent goods sections from individual excise product risk assessments. Risks are managed via compliance treatments that address issues in the micro and small to medium markets. Large market taxpayers are managed via client relationship managers.
Tobacco Risk Review, February 2014	Low The tobacco risk was reduced to 'Low' after the Plain Packaging Destruction program had been finalised. Four large entities account for 99 per cent of the total tobacco revenue.
Tobacco Risk Assessment December 2014	Moderate The tobacco risk was increased to 'Moderate'. While a small number of clients pay the majority of the tobacco excise revenue, there are a significant number of touch points by other entities when tobacco product is imported, moved or stored. This is where revenue leakage can occur. Three major clients pay 99 per cent of the total tobacco excise revenue (no reference was made to major clients' share of tobacco customs duty).
Tobacco Risk Assessment July 2015	Significant The heightened tobacco risk assessment is the result of: 'an observed increase in the number of entities displaying non-compliant behaviour that are importing tobacco and/or storing imported tobacco. As a result, there is a need to re-assess the risk (in particular the excise equivalent goods tobacco sub-risk) and adapt treatments accordingly.' Three major clients contribute 99 per cent of the excise tobacco revenue; and four importers paid 98 per cent of the tobacco customs duty for goods cleared on a Nature 30 Declaration.

Source: ANAO analysis of ATO documents.

4.8 With the exception of the heightened risk in 2012 as a result of the Plain Packaging Destruction Program, there is no clear rationale for the fluctuation in the risk ratings, given that:

- the profile of the tobacco industry in Australia has not changed (four 'key taxpayers' paying approximately 98 per cent of revenue and two main logistics suppliers); and

- specific risk drivers associated with excise equivalent goods⁴⁰ identified in 2015 (bar one related to compliance activities) are the same as those for the previous year.

4.9 The ATO advised that the reason for the changed risk ratings over the years is largely a consequence of shifts in focus brought by different ATO managers when scoping risk assessments. Most recently, the raising of the risk to ‘significant’ was driven by the reputational risk for the ATO and DIBP as a result of large seizures of illicit tobacco (through activities to address trade in the illicit tobacco market⁴¹) and a noted increase in the incidence of theft from smaller warehouses (that account for approximately two per cent of the revenue collected).⁴²

4.10 It may be that the higher risk rating in 2015 would have been appropriate in previous years, particularly as issues raised at Inter-agency Liaison Committee meetings back to 2010 (see paragraph 2.6) and consolidated in the gaps and vulnerabilities documents, indicated essential known weaknesses in the administration of the underbond system for excise equivalent goods.

Future arrangements for managing the tobacco risk

4.11 As previously discussed, since mid-2015, DIBP and the ATO advised that they have been working co-operatively to improve the joint management and responsibility for the administration of excise equivalent goods. Minutes from a joint DIBP / ATO workshop held on 15 October 2015 reflect wide ranging discussion on matters relevant to the joint agency working arrangements, including: each agency providing a briefing on their approach to compliance; developing an operational policy for risk and compliance activities for excise equivalent goods; overall improved communication and the sharing of information; and participation in a whole-of-government tobacco taskforce, targeting the illicit trade in tobacco.

4.12 In November 2015, DIBP provided an overview of new arrangements being implemented across the department and in the Australian Border Force for the management of risk associated with customs duty and the coordination of compliance activities, but more needs to be done to ensure that the risk associated with the operation of the underbond system for excise equivalent goods is sound, and reflects the knowledge and capability of both agencies.

40 Internal risk drivers specific to excise equivalent goods in 2015 included the: nature of the relationship between the ATO and DIBP to manage the tobacco sub-risk; lack of access by ATO staff to ICS and subsequent access to real time data; the ATO’s capacity to respond where serious non-compliance in warehouse administration has been identified—the ATO does not have the experience or resources to take control of a warehouse; and a fragmented approach to risk and compliance given the differing priorities and resource constraints across the agencies. All but the last risk driver were identified in the previous year.

41 Due to the low barriers to entry to the tobacco market, and its lucrative nature, more involvement by organised crime had been identified, with an increase in cases of fraud and theft from bonds since 2012.

42 The risk documents could also be written or presented in a format that more clearly sets out the factors being considered and the overall conclusion.

Recommendation No.3

4.13 To improve the assessment of risk associated with the administration of excise equivalent goods, the ANAO recommends that the ATO and DIBP develop working arrangements to share risk related information and intelligence and assess risks based on evidence and a joint understanding of the risk environment.

ATO response: *Agreed.*

4.14 *The ATO supports this recommendation. Work has progressed in this area, particularly in regards to the joint compliance operations between the Australian Border Force and the ATO into warehouses. The ATO will continue to work with DIBP to share intelligence and risk related information to inform our collective assessment of excise equivalent goods tobacco risk.*

DIBP response: *Agreed.*

4.15 *The Department supports this recommendation. Work has progressed in this area, particularly in regards to the joint compliance operation between the ABF and ATO into warehouses and 77G depots. Sharing of risk related information and intelligence plays a key role in compliance operations. The Department and the ABF will continue to develop measures to enhance information and intelligence sharing in conjunction with the ATO.*

Does the ATO effectively conduct compliance activities for tobacco excise equivalent goods?

The planning and implementation of compliance activities for excise equivalent goods moving through s.79 warehouses administered by the ATO could be improved, including by DIBP engaging with the ATO, as set out in the administrative framework. Within the ATO, there is a lack of process for the selection of warehouses (or other aspects of the tobacco industry) for targeted compliance activities, relying heavily on manual assessment. Testing of a sample of completed compliance activities for tobacco excise equivalent goods indicated the need for better recording in the ATO's systems.

4.16 The framework for administering excise equivalent goods requires the ATO and DIBP to coordinate their compliance activities, but prior to 2015 there was no evidence of any formal exchange between the agencies, assessed as a compliance risk in the 'gaps and vulnerabilities' document. In 2015–16, developments between the ATO and DIBP indicate a more co-ordinated approach, going forward, of all aspects of the administration of excise equivalent goods: in November 2015 for example, DIBP and the ATO agreed to undertake a series of joint compliance activities at s.79 warehouses administered by the ATO that are co-located with a Customs depot.

ATO compliance activities

4.17 Information on the ATO's compliance activities in relation to the administration of excise equivalent goods (all commodities) is provided to DIBP in the monthly Financial Summary

Reconciliation Reports.⁴³ Information on compliance activities was only included in these reports from 2013–14 onwards, as a result of an ANAO financial statements audit request for the information in July 2013. The number of completed compliance activities reported for 2012–13 to 2014–15 is set out in Table 4.3.

Table 4.3: ATO completed compliance activities for all excise equivalent goods, 2012–13 to 2014–15

	Warehouse checks	Remission / refund checks	Review	Audit
2012–13	17	93	3	0
2013–14	37	5	2	7
2014–15	36	2	3	7
Total	90	100	8	14

Note: Warehouse checks provide assurance that: the client is meeting requirements in regard to the security of the warehouse premises and the storage of goods; reviews and audits are targeted towards clients with complex issues; and remission and refund checks provide assurance about the destruction of tobacco products before approval of a claim.

Source: ATO Financial Summary Reconciliation Reports, June 2013–14 and June 2014–15, and ATO information for 2012–13.

4.18 It is difficult to identify the compliance activities that target tobacco excise equivalent goods: activities are not selected based on a specific commodity and (as previously discussed) wording on the warehouse licences does not necessarily stipulate the type of goods that can be stored in individual warehouses. For ANAO audit purposes, the ATO manually reviewed the record of completed compliance activities, identifying those most likely associated with tobacco goods, and provided data for the period 1 June 2012 to 30 April 2015 (Table 4.4), for ANAO testing, discussed later in this paper.

Table 4.4: ATO completed compliance activities for tobacco excise equivalent goods, 2012–13 to 30 April 2015

	Warehouse checks	Remission / refund checks	Review	Audit
2012–13	11	86	3	4
2013–14	15	3	3	3
1 July 2014–30 April 2015	13	2	1	3
Total	39	91	7	10

Source: ATO (The ATO later advised that 2 warehouse checks were undertaken in the period 1 May – 30 June 2015).

4.19 There are inconsistencies between the data sets reported in Tables 4.3 and 4.4: for example, Table 4.3 records no audit activity for 2012–13, with four audits reported in Table 4.4 for the same period. The ATO and the ANAO reviewed the data set (Table 4.4), subsequently revising

43 The reports include that warehouse checks are to gain assurance that the taxpayer is meeting (then) ACBPS requirements in regard to the security of the warehouse premises as well as uptake, storage and acquittal of excise equivalent goods and where relevant non-excise equivalent goods, but no evidence was provided as to what those requirements are.

down the number of warehouse checks most relevant to the management of tobacco excise equivalent goods to 20.

ANAO testing of a sample of completed compliance activities

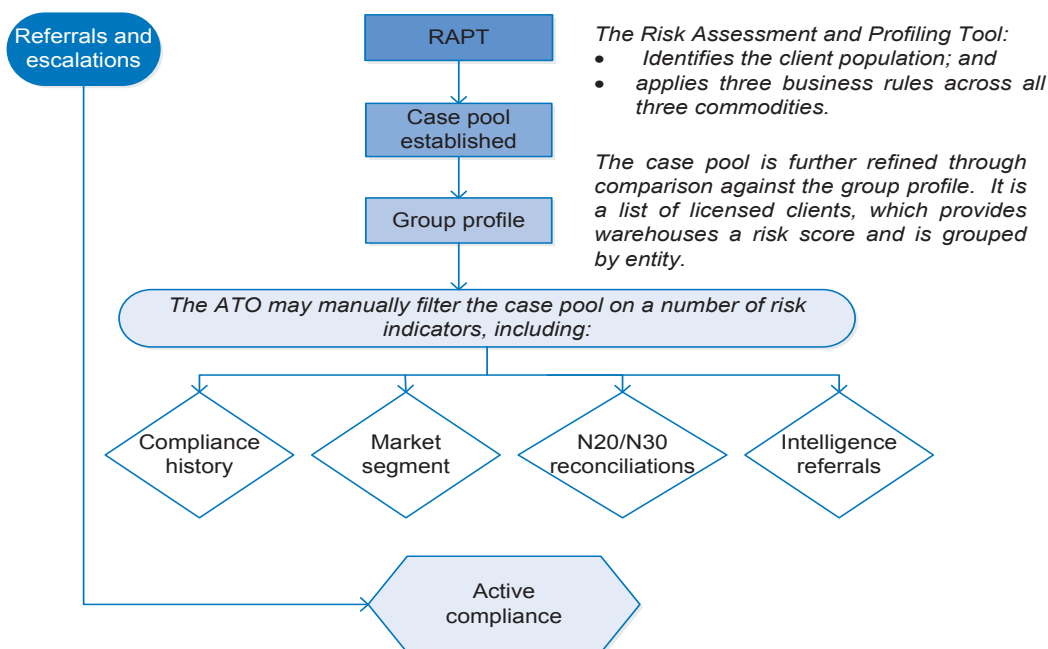
4.20 The ANAO examined all 37 identified compliance activities completed between 1 July 2012 and 30 April 2015, 20 warehouse checks and 17 reviews and audits. The purpose was to determine whether: the activities had been conducted on a sound risk basis; the activities were appropriately recorded and complied with procedures; and there was evidence of the ATO's response to the results of the activities.

Warehouse checks on s.79 warehouses administered by the ATO

Selecting warehouses to be checked

4.21 In February 2015, the ATO introduced a new systems-based tool for identifying warehouses to be checked, the Risk Assessment and Profiling Tool (RAPT). The tool enables partial automation of the case selection process (that was previously totally manual), but manual input is still required to complete the selection process. The selection process is set out in Figure 4.1.

Figure 4.1: Selection process for conducting s.79 warehouse checks, February 2015



Source: ANAO analysis of ATO information.

4.22 The ATO advised that there were no formal guidelines for case selection. Notes prepared by the ATO for the audit provided an outline of the selection process, based primarily on the work

of one or two staff in the Excise Product Assurance branch.⁴⁴ There was also no targeted case selection based on specific risks for tobacco excise equivalent goods. Rather, the risk rules in the RAPT warehouse model applied generically to the three excise equivalent commodities, irrespective of any variation in the risks associated with each commodity.

Conducting warehouse checks

4.23 The ATO conducts checks on the operation of a warehouse, not by the control of a specific commodity. As previously discussed, identifying completed warehouse checks that were most relevant to the administration of tobacco excise equivalent goods required a manual review of each completed activity. In the period 2012–13 to 2014–15, the ATO identified 20 completed warehouse checks (in the data provided in April 2015), where the goods stored in the warehouse were predominantly (but not necessarily exclusively) tobacco.⁴⁵

4.24 The ANAO identified key elements of a warehouse check, included in the *EEG Warehouse Compliance Guide*, at March 2015, and tested if they were completed for the 20 finalised cases.⁴⁶ Results of the ANAO review, including timeliness of completed cases, are summarised in Table 4.5.

4.25 The analysis identified shortcomings in case documentation: there was no clear trigger for compliance activity in 40 per cent of cases; and no evidence of a Corporate Research Environment report in 61 per cent of applicable cases. Warehouse Check Reports did not detail a risk rating in 63 per cent of relevant cases; nor was there a clear recommendation in 19 per cent of relevant cases. Timeliness was also an issue—as well as seven cases (35 per cent) that exceeded the timeliness standard for completion, additional delays averaging 69 days between the creation of cases and their allocation to case officers were noted, with one case being delayed 214 days until it was allocated.

Analysis of the results of warehouse checks

4.26 There were few instances of non-compliance identified, with only one enforcement action from the 20 checks (a demand for recovery).

4.27 The ATO follows a formalised procedure in conducting warehouse checks, with segregation of case selection, performance and review. However, relatively few tobacco warehouse checks are undertaken annually, and as checks are based on warehouse operations rather than commodity, it would be difficult for the ATO to draw conclusions regarding the warehouse management of tobacco products.

44 The ATO recognises the dependency on a small number of staff. The ATO's introduction of 'smarter data' in 2014–15 aims to enhance its ability to produce better data and reduce the level of manual manipulation required to analyse data.

45 There were three completed, tobacco-related warehouse checks in 2012–13; nine in 2013–14; and eight in 2014–15 (to 30 April 2015). On testing, one warehouse was found to operate under a licence for both alcohol and tobacco, but stock uptake records only referred to alcohol.

46 Requirements for the conduct of a warehouse check are set out in the ATO's *Warehouse Check Job Aid*, developed in October 2010, updated in May 2011 with very little change, and again in September 2011 when it became the *Warehouse Check Job Guide*. The current online version, *EEG Warehouse Check Compliance Guide* was developed in May 2014, and subsequently updated—the ANAO referring to the March 2015 version as the most current. There were no significant changes made between manual or online guides.

Table 4.5: ANAO analysis of completed warehouse checks 1 June 2012–30 April 2015

Key element	Yes	No	NA	Total
Was there a clear trigger for raising a check for each case?	8	12	0	20
Was there a completed Context Document for each case? ¹	20	0	0	20
Was there a Corporate Research Environment document for each case? ²	7	11	2 (new licences)	20
Was there a Warehouse Check Report on file?	15	1	4 ³	20
Did the Warehouse Check Report for each case detail:				
A risk rating?	6	10	4	20
Clear recommendations?	13	3	4	20
Were finalisation letters on file for each case?	15	5 ⁴	0	20
Was the case approved and signed off?	20	0	0	20
Was the timeliness standard met for completion? (60 days)	13	7	0	20

Note 1: A 'Context Document' is provided to the checking officer by the team leader, when the case is allocated, setting out research on the client, including information such as licence conditions and previous reports. The context document also serves as the case plan.

Note 2: A 'Corporate Research Environment' report is generated from DIBP's ICS and shows details of N20 and N30 transactions, and what duty was paid on goods that left the warehouse. Of the cases without a Corporate Research Environment report, the ATO subsequently advised that these reports were not required where there was no import or export of goods for that warehouse (five cases); nor for early exits (two cases). The ATO also noted that two reports were located in other systems. However, the *EEG Warehouse Check Guide* requires a Corporate Research Environment report to be generated, include 'nil' returns, and to precede a decision as to an early exit.

Note 3: These four cases were 'early exits' for which Warehouse Check Reports were not prepared.

Note 4: The ATO subsequently advised that finalisation letters were not required for early exits or supervised stock movements. However, the *EEG Warehouse Check Guide* requires that all cases have client contact, and this is fully recorded.

Source: ANAO, based on ATO information.

2013–14 ATO financial statements

4.28 In its audit of the ATO's 2013–14 financial statements, the ANAO observed that improvements could be made in relation to the documentation of compliance checks on warehouses storing excise equivalent goods. These observations focussed on improving the transparency of selected compliance activities such as two-way stock counts and ensuring that all supporting documentation can be clearly linked back to the original test.

Conducting reviews and audits

4.29 Reviews and audits are compliance actions that may be triggered by results from a warehouse check (usually on the advice of compliance officers) or examine other aspects of taxpayers' business operations. Of the 17 completed reviews and audits conducted between 1 July 2012 and 30 April 2015 (Table 4.4):

- ten were conducted in s.79 warehouses administered by the ATO, six were key taxpayer reviews and one was as a result of a voluntary disclosure;

- four were planned and 13 were unplanned⁴⁷; and
- ten were from the micro and small to medium enterprise market segments and seven were from the large market.

4.30 The ATO could not provide any process documentation for the conduct of an audit or review, describing the activity as a ‘deep dive’ into the operation of a warehouse or other aspect of the business, adding that the process varies between cases depending on what was raised in the warehouse check, or other issues raised by compliance staff.

4.31 In the absence of process documentation, ATO compliance staff conducted a ‘walk through’ for ANAO analysts of a number of completed audits and reviews as recorded in the ATO’s case management system (Siebel). The audit team developed a short test program based on Siebel records. The results of the analysis are set out in Table 4.6.

Table 4.6: Conduct of tobacco excise equivalent goods reviews and audits

Key element	Yes	No	Total
Was there a clear reason/trigger for the review or audit?	16	1	17
Was the result clearly recorded?	14	3	17
If the result had a penalty, was this recorded?	2	1	3
Was the timeliness standard met? (number of days) ¹	8	8 ²	16

Note 1: There is no timeliness benchmark for voluntary disclosures (one in the test sample).

Note 2: The ATO advised that the deadlines had been varied for two cases, but evidence of the variations were not readily available in the case management system.

Source: ANAO, based on ATO information.

4.32 The testing indicated that the reasons for conducting the reviews and audits, and the results, were clearly recorded. With regard to timeliness, the standard varied between specific review or audit products—from 60 to 365 days: as at April 2015, there were eight different timeliness standards (cycle times) for the completion of reviews and audits. Case officers averaged 118 days, between allocation and closure dates, to complete a case. Half of all cases tested did not meet the relevant timeliness standard—and additional delays averaged 53 days.

4.33 Overall, there is room to improve the selection and targeting of compliance activities undertaken by the ATO in the agency’s administration of tobacco excise equivalent goods. Improved co-operation between the ATO and DIBP in the assessment of risk associated with the administration of these goods will provide a sound base for the development of a compliance plan. In addition, the volume of compliance activities undertaken each year should be reviewed, given the recent increase in the assessed risk of non-compliance.

47 Planned activities are selected from a formal case selection process in advance of the compliance activity taking place. Unplanned activities are triggered by a wide range of factors, including theft, revenue risk, incorrect reporting and N20 / N30 acquittals.

Recommendation No.4

4.34 To improve the effectiveness of compliance activities associated with the storage and movement of excise equivalent goods, the ANAO recommends that:

- (a) DIBP engages with the ATO to coordinate compliance activities in s.79 warehouses, in accordance with the head Memorandum of Understanding;
- (b) the ATO develops more specialised and systematic processes for selecting warehouses (or other aspects of the tobacco industry) for targeted compliance activities; and
- (c) the ATO reinforces and monitors the appropriate recording of tobacco excise warehouse compliance activities.

ATO response: *Agreed.*

4.35 *The ATO supports this recommendation and is currently working with DIBP to expand the data fields included in the automated nightly data upload to the ATO, for risk monitoring and the targeting of compliance activities. The ATO will work with DIBP to refine processes for selecting warehouses for targeted compliance activities.*

DIBP response: *Agreed.*

4.36 *The Department supports this recommendation. Work has progressed in this area through the standing up of a joint compliance operation between the ABF and ATO into warehouses and 77G depots:*

- (a) *The standing up of the operation established a process for the selection of warehouses to target non-compliance with the Customs Act 1901 and the Excise Act 1901 in regards to excise equivalent goods.*
- (b) *The ABF will work with the ATO to refine processes for selecting warehouses for targeted compliance activities.*



Grant Hehir
Auditor-General

Canberra ACT
5 May 2016

Appendices

Appendix 1 Entity responses



Australian Government
Australian Taxation Office

Second Commissioner of Taxation

Ms Michelle Kelly
Group Executive Director
Performance Audit Services Group
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Ms Kelly

AUSTRALIAN NATIONAL AUDIT OFFICE PERFORMANCE AUDIT OF THE
ADMINISTRATION OF TOBACCO EXCISE EQUIVALENT GOODS

Thank you for your letter dated 30 March 2016 and for the opportunity to provide comments on the proposed report on the Administration of Tobacco Excise Equivalent Goods.

The ATO agrees with the four recommendations as presented in the proposed audit report.

We have attached the ATO's response to the ANAO recommendations (Annexure 1) and a 'Summary response' for inclusion in the final report (Annexure 2) as requested.

I would like to thank the Australian National Audit Office audit team for the cooperative and professional manner they have adopted in working with us on this matter. I look forward to continuing the good working relationship between our organisations.

If you require further information on this matter, please contact Assistant Commissioner, Tom Wheeler on (08) 8218 1912.

Yours sincerely



Neil Olesen
Second Commissioner
Australian Taxation Office

Date: 27 April 2016

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Australian Government
Department of Immigration
and Border Protection



Australian
BORDER FORCE

Ms Michelle Kelly
Group Executive Director
Performance Audit Services Group
Australian National Audit Office
19 National Circuit
BARTON ACT 2600

Dear Ms Kelly

Thank you for your letter of 30 March 2016 to the Secretary inviting comments on the proposed Australian National Audit Office (ANAO) Audit Report on the *Administration of Tobacco Excise Equivalent Goods* (the report).

The Department of Immigration and Border Protection (the Department) accepts the four recommendations presented in the Section 19 report and acknowledges that further work is required to improve the cooperative relationship between the Department, the operational arm of the Department – the Australian Border Force (ABF) and the Australian Taxation Office (ATO) in the administration of Excise Equivalent Goods (EEGs). The Department's response to the report recommendations is at [Appendix 1](#).

Since the integration of the Department and the Australian Customs and Border Protection Service (ACBPS), the Department and the ABF have strengthened ties with the ATO through developing channels for information sharing, joint operations and other pathways to ensure appropriate treatment of risk around EEG goods at and beyond the border. The report reinforces the importance of this work. The Department and the ABF will continue to develop a close and collaborative working relationship in the indirect tax and EEG space.

The Department notes that the report provides examples of importations of illicit tobacco and includes discussion on the illicit tobacco market. While Illicit tobacco presents complementary risks, these do not directly impact the administration of the EEG regime. The Department believes the illicit tobacco market is not indicative of the effectiveness of EEG administration by either the ATO or the Department.

The Department appreciates the efforts and professionalism of the Australian National Audit Office team whilst conducting the audit.

If you would like any further information on this matter, please have your staff contact Andrew Chandler, Assistant Secretary, Trade and Customs Branch on (02) 6264 3046.

Yours sincerely

Rachel Noble
Deputy Comptroller-General
Policy Group

27 April 2016

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Appendix 2 ANAO financial statement audit findings 2014–15 regarding the Australian Customs and Border Protection Service customs duty compliance program

The ACBPS collected \$10.9 billion in customs duty revenue in 2014–15. Customs duty is calculated and collected under a self-assessment regime, under which industry and the international trading community self-assess their customs duty obligations associated with the importation of goods and services. The ACBPS had a compliance program that included a range of activities designed to support customs duty revenue collection by identifying revenue evasion before, at, and after the border.

As part of the 2014–15 audit, the ANAO reviewed ACBPS' customs duty compliance program and identified weaknesses in the governance and management oversight arrangements, including a lack of:

- regular oversight and monitoring of the compliance program;
- evidence of how the performance of the compliance program was regularly measured and reported, and how relevant and appropriate opportunities for improvements were identified;
- consistent ACBPS-wide policies and procedures related to planning, managing and executing compliance activities;
- an end-to-end risk assessment process, register or plan for compliance activities during 2014–15; and
- a documented rationale for the sample size and selection methodology that is consistent with the level of assurance that the ACBPS aimed to achieve from the compliance program.

As a result of ACBPS's merger with DIBP on 1 July 2015, the department has advised that it is taking steps to strengthen the governance arrangements related to the compliance program. The ANAO will review the progress made by DIBP to improve the customs duty compliance program as part of the 2015–16 financial statement audit.

