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# Tobacco tax gap

Compare the 2022–23 tobacco tax gap to findings from previous years.

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# Latest estimates and findings

How we combat illicit tobacco behaviours with help from other government agencies.

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The tobacco market includes both legal and **illicit tobacco** for sale. We estimate the size of the tobacco market at 9,392 tonnes in 2022–23, 37% lower than what it was six years ago. Over this period, increasing excise rates drove up the amount of **tobacco duty paid**. The duty paid reached $12.7 billion in 2022–23.

We estimate a further $2.7 billion of duty was evaded from illicit tobacco reaching the market. The Illicit Tobacco Task Force (ITTF), led by the Australian Border Force (ABF), work across several government agencies to combat this illicit tobacco market. Illicit tobacco includes international imports and domestically sourced tobacco. The ATO is responsible for excise duty payable on domestically grown and/or manufactured tobacco. ABF is responsible for the excise equivalent duty payable on imported tobacco and tobacco products.

Together in 2022–23, we seized the highest volume of illicit tobacco ever recorded. Despite these efforts and in contrast to a shrinking market, illicit tobacco is still increasing. We estimate approximately 18% (1,656 tonnes) of all tobacco for sale is illicit.

The duty value would have been $2.7 billion. This gives rise to a net tax gap of 14.3%.

- $2.3 billion duty was evaded through illicit importation
- $0.4 billion was evaded through illicit domestic production

We estimate a gross gap of 3,834 tonnes, or 33.1%. This is the amount of illicit tobacco that attempted to enter the Australian market. It includes the tobacco seized and the amount undetected that made it to market.

Note: Vapes, e-cigarettes and other similar items, including those containing nicotine, are not subject to excise duty and are not part of the tax gap estimate.

Table 1 shows the revenue impacts of these events over the last 7 years.

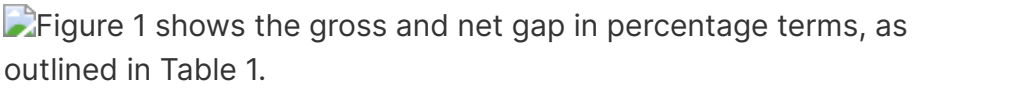
Table 1: Tobacco tax gap, 2016–17 to 2022–23

| Element | 2016–17 | 2017–18 | 2018–19 | 2019–20 | 202( 21 |
|---|---|---|---|---|---|
| **Duty paid ($m)** | 10,612 | 11,914 | 12,147 | 12,781 | 14,2( |
| **Gross gap – illicit tobacco attempted to enter the market($m)** | 980 | 1,310 | 1,744 | 2,118 | 3,9 |
| **Seizures – Illicit tobacco seized before entering the market ($m)** | 359 | 473 | 708 | 784 | 2,0 |
| **Net gap – undetected illicit tobacco that made it to market ($m)** | 621 | 837 | 1,036 | 1,334 | 1,9 |
| **Potential tobacco market – all legally imported and attempted illicit tobacco supply in** | 11,592 | 13,224 | 13,891 | 14,899 | 18,2 |

| | | | | | |
|---|---|---|---|---|---|
| **the absence of government intervention** | | | | | |
| **Net gap (%)** | 5.4 | 6.3 | 7.5 | 9.0 | 10 |
| **Gross gap (%)** | 8.5 | 9.9 | 12.6 | 14.2 | 21 |

Figure 1 shows the gross and net gap in percentage terms, as outlined in Table 1.

**Figure 1: Gross and net tobacco tax gap percentages, 2016–17 to 2022–23**




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# ATO action to combat illicit tobacco

How we combat illicit tobacco behaviours with help from other government agencies.

**Last updated** 31 October 2024

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Our estimates of the duty evaded include work done by us, the Australian Border Force (ABF) and other government agencies to combat **illicit tobacco**.

## Illicit Tobacco Taskforce

On 1 July 2018, the Illicit Tobacco Taskforce (ITTF) was established as part of new reforms. Under the combined power of these government agencies, the ITTF fights back against organised criminals operating multimillion dollar crime syndicates in the **shadow economy**.

The ITTF draws on the expertise and advanced capabilities of the:

- ATO
- ABF
- Department of Home Affairs
- Australian Criminal Intelligence Commission (ACIC)
- Australian Transaction Reports and Analysis Centre (AUSTRAC)
- Commonwealth Department of Public Prosecutions (CDPP) and law enforcement partners.

In its first 3 years, the ITTF seized more than 264 tonnes of illicit tobacco and 540 million cigarettes, with an estimated excise value of over $870 million. This demonstrates how effectively the partner agencies work together to stamp out illicit tobacco.

The ITTF uses enhanced investigative and intelligence gathering methodologies to disrupt illicit activity by:

- targeting international and domestic supply chain vulnerabilities through enhanced data analysis and identifying Priority Illicit Tobacco Networks using a counter networking approach
- targeting the criminal economy and responding to large profits realised by organised criminals in cooperation with the Criminal Assets Confiscation Taskforce and the Serious Financial Crime Taskforce
- using specialist law enforcement capabilities
- using the data-mining and financial analysis capabilities of AUSTRAC and the ATO to trace illicit financial flows from domestic and international trafficking

- working closely with the CDPP to prepare cogent briefs of evidence in both the criminal and civil (proceeds of crime) jurisdictions
- working with domestic and international law enforcement and customs bodies to leverage additional capabilities and support.

ITTF's achievements demonstrate the effectiveness of Australia's enhanced approach in tackling illicit tobacco in the community. To guide our approach, we use the experiences of other countries including the United Kingdom, the strategic insights of ACIC and the findings of the Shadow Economy Taskforce.

## ATO Domestic Illicit Tobacco response

Complementing our support to the ITTF, we conduct additional operations to seize and destroy domestically grown and manufactured illicit tobacco crops. No licenses have been issued to manufacture tobacco domestically since 2015.

We receive referrals from the ITTF and state law enforcement partners and tip-offs from industry and the community.

Between 1 July 2018 and 30 June 2024, our Illicit Tobacco Team completed 90 operational activities. These included 19 ITTF (whole of government) operations, 31 ATO specific operations and 40 state law enforcement support operations.

These operations resulted in:

- 627 acres of illicit tobacco crops located, seized and destroyed with a total weight of 3,746,240 kilograms
- 39,224 kilograms of loose-leaf tobacco located, seized and destroyed
- 21,759,340 cigarettes located, seized and destroyed
- total estimated equivalent tobacco duty foregone value of above $723 million
- started prosecutions utilising new offence provisions in schedule 308B Tax Administration Act.

The domestic response also includes some small funding for ATO auditors who support the ITTF with the financial analysis relating to Priority Illicit Tobacco Network Targets.

## Tobacco legislation

On 16 August 2018, the government passed the Treasury Laws Amendment (Illicit Tobacco Offences) Bill. It created a new tobacco offence regime and increased the penalties to provide a greater deterrence to illegal activity.

The penalty is calculated in multiples of a **penalty unit**.

This new offence legislation under Division 308 of the *Taxation Administration Act 1953* (Cth) has been used widely to further illicit tobacco operations. Results of the previously mentioned 90 operational activities include:

- 44 briefs of evidence being referred to the Commonwealth Director of Public Prosecutions
- 27 convictions in relation to tobacco related offending
- 9 prosecution matters still proceeding through the court system.

Sentences have ranged from 4 months imprisonment (suspended for 12 months conditional on good behaviour) to 3 years imprisonment (eligible for parole after 2 years and 3 months).

## Communication approaches

Our communication approach focuses on the ATO (and other partner agencies under the ITTF) to demonstrate our effectiveness in dealing with domestically grown and manufactured illicit tobacco.

We use a range of communication tactics, including **media releases**, to let people know about the risks of being associated with the illicit tobacco trade. This increases community awareness and ensures people continue to refer illicit tobacco crops to state or federal law enforcement agencies or the ATO.

We also use targeted communications to inform the community about key risk areas including known tobacco growing hotspots, criminal prosecutions and even the involvement of Serious Organised Crime. We also promote the important work of the ITTF and ATO in undertaking search warrants, crop destruction as well as crop to shop strategies to address illegal tobacco in retail stores.

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# Methodology

What method we use to estimate the tobacco tax gap.

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Step 4: Compare total illicit amounts to legal clearances

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We use a 5-step model-based bottom-up **method to estimate the tobacco tax gap**. This approach considers the different ways tobacco can make it onto the Australian market and estimates the amount of illicit tobacco in each channel.

## Overview

This approach is the most suitable given the body of cross-agency seizure data available. Data is sourced from:

- Home Affairs – international sea and air cargo and international post supply channels
- ATO – domestic chop-chop manufacture

- ATO and Home Affairs – customs warehouses (reflecting the involvement of both agencies in administering this part of the system).

**Figure 2: Administrative responsibility and supply channels for illicit tobacco**


Figure 2 shows the administrative responsibilities and supply channels for illicit tobacco: ATO administers domestic chop-chop and warehouse leakage, and the Department of Home Affairs (Australian Border Force) manages warehouse leakage, international postage, international passengers, and sea and air cargo.

# Step 1: Estimate illicit tobacco arriving through importation

We estimate how much illicit tobacco is imported in the following 3 parts. Then we add the parts together to estimate the net amount before any seizures.

## Volume of undetected illicit tobacco making it to the market

The Australian Border Force (ABF) provided intelligence for 2015–16 on tobacco seizures that excluded targeted detections and high-risk seizures. We used this to inform the volume of undetected illicit tobacco making it to the market.

Each subsequent year we use the total of undetected imported illicit tobacco that made it to market from the previous year as a base. That is done by combining steps 3 and 5. We adjust this quantity based on comparing illicit to legal purchase prices. A widening price gap indicates illicit tobacco supply is increasing.

## Substitution for illicit supply lost through moving the taxing point upstream

These changes have effectively eliminated duty evaded through the warehousing system from 2018–19 onwards. But the availability of illicit tobacco is increasing. This demonstrates that suppliers have expanded through existing channels.

We have reflected this by increasing the undetected illicit tobacco in the importation channel by some of the illicit tobacco previously

supplied through warehousing. See step 3 for detail.

### Illicit tobacco seizures by ABF

This is the actual volume of illicit tobacco detected and seized by ABF.

## Step 2: Estimate the size of domestic chop-chop cultivation

Licences are no longer issued for tobacco manufacture in Australia for either commercial or personal use. All tobacco grown in Australia is illicit.

We are responsible for managing the domestic manufacture of tobacco. We conduct crop seizures in partnership with other agencies such as the ABF and state police.

We estimate the tobacco supplied in this channel in 2 parts.

In the first part, we analyse the value of seizures, risk and intelligence referrals and create an uplift factor. This covers domestically manufactured tobacco that has not been detected or reported to authorities. We develop this uplift through referencing under-reporting of crime statistics from the Australian Institute of Criminology.

In the second part, we substitute for illicit supply lost through moving the taxing point upstream from warehousing to point of importation. These changes have effectively eliminated duty evaded through the warehousing system from 2018–19 onwards. But the availability of illicit tobacco is increasing. This demonstrates that suppliers have expanded through existing channels.

We have reflected this by increasing the undetected illicit tobacco in the domestic manufacture channel by some of the illicit tobacco previously supplied through warehousing. See step 3 for detail.

## Step 3: Analyse the licensed warehouse system

Before July 2019 most tobacco duty on imports was deferred until it exited a licensed warehouse. Goods that entered ‘underbond’ were held in the warehouse system and the duty was payable when it left the warehouse.

While the tobacco was legally imported, duty evasion could occur when it entered the warehouse system but exited without duty being paid. It could occur because of:

- theft
- goods for export being diverted
- incorrect weights recorded during importation.

We would do an inventory reconciliation to understand the size of the problem.

From 1 July 2019, importers can no longer transfer tobacco into a bonded warehouse. They now must pay all duty and tax liabilities when tobacco enters the country.

These changes have effectively eliminated duty evaded through the warehousing system from 2018–19 onwards. But the availability of illicit tobacco is increasing. This demonstrates that suppliers have expanded through existing channels.

We have increased illicit tobacco supplied through the other channels to reflect this. See steps 1 and 2.

We did not increase it by the full amount that had previously been lost through the warehousing system. This is because some illicit suppliers would have stopped their activity when another channel was not available.

## Step 4: Compare total illicit amounts to legal clearances

We combine the estimates from steps 1 to 3 to get the total of illicit tobacco from all the supply channels in Australia.

In total, 7,736 tonnes of tobacco were legally cleared in 2022–23. Adding the illicit amount gives the amount theoretically subject to tobacco duty.

A portion of this would not be realistically recoverable even if the illicit market was eliminated. This is because illicit tobacco smokers would likely smoke less if they had to buy more expensive legal tobacco.

## Step 5: Deduct seizures to determine net gap

In this step we deduct the total of ATO and ABF illicit tobacco seizures from the gross gap to determine the net gap. This includes seizures across the sea and air cargo channels, international post and domestic crop destructions.

## Summary of the estimation process

Table 2 shows each step of the estimation process. The results are given by tonnes and dollar value, as well as the gross and net gap percentages.

### Table 2: Applying the methodology for tobacco duty tax ga

| Step | Description | 2016–17 | 2017–18 | 2018–19 | 2019–20 |
|---|---|---|---|---|---|
| **1a** | Estimate of illicit tobacco importations (tonnes) | 878 | 978 | 1,367 | 1,375 |
| **1b** | Estimate of illicit tobacco importations ($m) | 659 | 866 | 1,441 | 1,739 |
| **2a** | Estimate of illicit domestic chop-chop cultivation (tonnes) | 195 | 281 | 287 | 300 |
| **2b** | Estimate of illicit domestic chop-chop cultivation ($m) | 146 | 248 | 302 | 379 |

| | | | | | |
|---|---|---|---|---|---|
| **3a** | Analysis of licensed warehouse leakages (tonnes) | 233 | 222 | 0 | 0 |
| **3b** | Analysis of licensed warehouse leakages ($m) | 175 | 196 | 0 | 0 |
| **4a** | Gross gap (total Step 1–3) (tonnes) | 1,305 | 1,481 | 1,654 | 1,675 |
| **4b** | Gross gap (total Step 1–3) ($m) | 980 | 1,310 | 1,744 | 2,118 |
| **4c** | Legal clearances of tobacco (tonnes) | 14,135 | 13,464 | 11,520 | 10,110 |
| **4d** | Legal clearances of tobacco ($m) | 10,612 | 11,914 | 12,147 | 12,781 |
| **4e** | Total theoretical clearances of tobacco (tonnes) | 15,440 | 14,945 | 13,174 | 11,785 |
| **4f** | Total theoretical clearances of tobacco ($m) | 11,592 | 13,224 | 13,891 | 14,899 |
| **5a** | Seizures and compliance | 478 | 535 | 671 | 620 |

| | | | | | |
|---|---|---|---|---|---|
| | outcomes (tonnes) | | | | |
| **5b** | Seizures and compliance outcomes ($m) | 359 | 473 | 708 | 784 |
| **5c** | Net gap (Gross gap less seizures and compliance) (tonnes) | 827 | 946 | 983 | 1,056 |
| **5d** | Net gap (Gross gap less seizures and compliance) ($m) | 621 | 837 | 1,036 | 1,334 |
| **5e** | Gross gap ($m) (%) | 8.5% | 9.9% | 12.6% | 14.2% |
| **5f** | Net gap ($m) (%) | 5.4% | 6.3% | 7.5% | 9.0% |

# Limitations

For each of the 3 core components of the model, the following limitations apply:

## Sea, air and international post statistical model

The methodology assumes the sampling data set is a truly random sample. Where the sampling method has changed from the original design, the methodology analyses the relationship differences between the historic and current intervention activities.

## Domestic chop-chop analysis

The revenue forgone figure is approximate given the high-level nature of some of the referrals. Judgment is required regarding the likely yield for given acreages under cultivation. This includes plant spacing, the

quality of crop management regarding fertiliser and pesticides and the quality of seed.

## Warehouse analysis

Included for historical purposes. Previously warehouse analysis was contingent on the quality of data entry by each warehouse licensee or customs broker. Keying or inventory errors may affect the result. This reconciliation may not detect under-reporting of physical quantities of tobacco into the data system.

## Pricing

The calculation of the available illicit tobacco in the market relies on the relative price differences between legal and illicit tobacco.

## Legal tobacco market suppliers

The revenue integrity of large tobacco companies is monitored through transaction assurance warehouse checks, our client relationship management framework and continuing intelligence and monitoring activities. We assume any excise lost from legal market suppliers is immaterial.

## Theoretical tax

### Tobacco excise duty realistically recoverable

We recognise that illicit tobacco smokers may smoke less if they must pay the higher legal price that includes tobacco duty. This would impact on the amount of tobacco duty realistically recoverable if the illicit market was eliminated.

**Gross gap** is the amount of illicit tobacco attempting to enter the market.

If all work to combat illicit tobacco stopped, it is likely that the same volume of illicit tobacco would outstrip consumer demand and the profits would fall making it less attractive for illicit suppliers.

Likewise, if all tobacco attempted to enter the market was legal the volume would decline. This is because the profits would decline due to excise duty paid. We see behaviour in the fall of legal importations over the last 7 years.

See our **glossary of terms used in tax gaps**.

## Updates and revisions to previous estimates

Each year we refresh our estimates in line with the annual report. Changes from previously published estimates occur for a variety of reasons, including:

- improvements in methodology
- revisions to data
- additional information becoming available.

The ATO is assessing additional information to supplement analysis of the tobacco market. We expect this to shore up for inclusion in future gap estimates.

The 2022 Program version revised the estimates for the previous 3 years. This considered the change in methodology regarding tobacco previously considered lost through the warehousing system. The change pushed up both the net and gross estimates. No further methodology changes have occurred in the following year's Programs.

Figure 3 shows the net gap from our current model compared to the previous estimate.

**Figure 3: Current and previous tobacco duty tax gap estimates, 2015–16 to 2022–23**


**Figure 3 displays our previous and current net gap estimates, as outlined in Table 4.**

### Table 3: Current and previous tobacco net gap % estimate

| | 2015-16 | 2016–17 | 2017–18 | 2018–19 | 2019–20 |
|---|---|---|---|---|---|
| **2024 program** | 4.9 | 5.4 | 6.3 | 7.5 | 9 |
| **2023 program** | 4.9 | 5.4 | 6.3 | 7.5 | 9 |

| | | | | | |
|---|---|---|---|---|---|
| **2022 program** | 4.9 | 5.4 | 6.3 | 7.5 | 8.9 |
| **2021 program** | 4.9 | 5.4 | 6.3 | 6.3 | 6.2 |
| **2020 program** | 4.9 | 6.6 | 6.5 | 6 | n/a |
| **2019 program** | 5.5 | 5 | 5 | n/a | n/a |
| **2018 program** | 5.6 | n/a | n/a | n/a | n/a |

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# Reliability

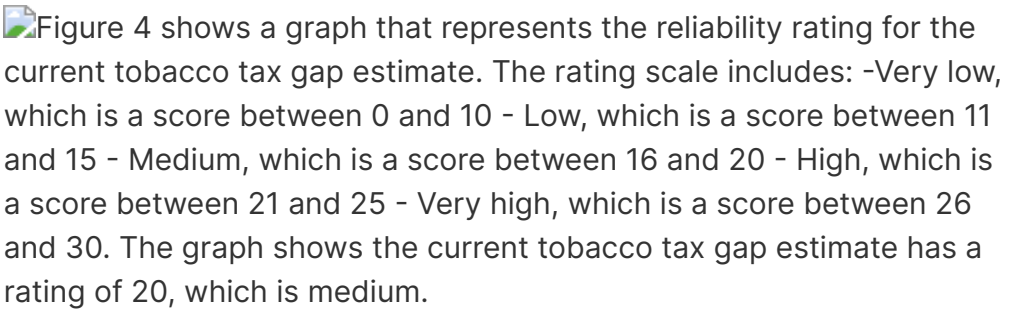
How we make sure the tax gap estimate is reliable.

**Published** 31 October 2024

We seek feedback and advice about how we estimate the gap from our external and internal subject matter experts. Based on the advice, the reliability rating for this estimate is **medium** with a score of 20.

As with all gap estimates, the tobacco tax gap estimate remains sensitive to our assumptions. We will continue to monitor and test the overall approach as we improve it in future releases.

**Figure 4: Reliability rating scale from very low to very high – tobacco tax gap**


Figure 4 shows a graph that represents the reliability rating for the current tobacco tax gap estimate. The rating scale includes: -Very low, which is a score between 0 and 10 - Low, which is a score between 11 and 15 - Medium, which is a score between 16 and 20 - High, which is a score between 21 and 25 - Very high, which is a score between 26 and 30. The graph shows the current tobacco tax gap estimate has a rating of 20, which is medium.

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