

Tax Working Group Public Submissions Information Release

Release Document

February 2019

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From: Bottriell, Kyla [1]
Sent: Thursday, 1 November 2018 2:17 PM
To: TWG Submissions
Subject: Philip Morris (New Zealand) Limited - Tax Working Group Submission
Attachments: Philip Morris New Zealand Limited - Tax Working Group Submission 1.11.18.pdf

Dear Tax Working Group,

Thank you for the opportunity to provide our views on the future of tax in New Zealand. Please find Philip Morris (New Zealand) Limited's feedback on the Interim Report attached.

We also wish to submit a request to meet with the Group, to offer additional supporting information and answer any questions. Please advise at your convenience if there are opportunities to appear before Members in the coming weeks.

Kind regards,

Kyla Bottriell
External Affairs Manager
Philip Morris (New Zealand) Ltd
[1]



PHILIP MORRIS (NEW ZEALAND) LIMITED

FISCAL POLICY CAN CONTRIBUTE TO ACHIEVE SMOKEFREE AOTEAROA 2025

Summary

Philip Morris International (PMI) is a leading tobacco company engaged in the manufacture and sale of cigarettes and smoke-free products. We are building our future on smoke-free products that are a much better consumer choice than continuing to smoke cigarettes. Our vision is to replace cigarettes as soon as possible, to the benefit of adults who would otherwise continue to smoke. Since 2008, we have invested more than USD 4.5 billion (NZD 6.8 billion) to achieve this business transformation, in areas such as fundamental research, product and commercial development and production capacity.¹

Philip Morris (New Zealand) Limited (PMNZ) is the New Zealand subsidiary of PMI. PMNZ welcomes the Government's initiative to improve the fairness, balance, and structure of the tax system and we thank the Tax Working Group for the opportunity to contribute to the national conversation on the future of the tax system and how it underpins the living standards of New Zealanders. We particularly welcome the Group's interim report and its findings on corrective taxation.²

As the interim report notes, corrective taxes are primarily intended to change consumer behaviour. Given the serious health risks linked to smoking, and the associated externalities, we support the Government using the tax system to discourage it. However, the interim report also acknowledges that high tobacco taxes have led to some unwelcome and unintended consequences, including a disproportionate impact on the poorest in society,³ and increasing criminal activity,⁴ while their effectiveness appears to be reducing.⁵

The above situation creates a dilemma for policy makers who have to weigh the positive aspects of increased tobacco taxation in reducing consumption against the economic welfare effects on those who continue to smoke. However, technological innovation over the last decade, and the launch of smoke-free products, present an opportunity and a solution to address this dilemma for adult smokers who would otherwise continue to smoke.

Smoke-free products have significant potential to reduce smoking rates and the harms caused by smoking, and are essential to achieve the Government's goal of a smoke-free New Zealand by 2025. Fiscal policies can play an important role in supporting a smoke-free transition through changing consumer and producer behaviour. We suggest that the Tax Working Group recommends changes to the tax system to encourage such an approach, helping to ensure that smoke-free products are affordable for all adult smokers who have not quit smoking, and direct industry to focus its research and innovation towards less harmful alternatives.

PMNZ engaged TDB Advisory to analyse the current tobacco tax policy and provide independent advice on how New Zealand's tax system can be updated to include smoke-free products, consistent with the government's evolving policy on tobacco harm reduction.

¹ PMI's Latest Clinical Results: Findings Add to Extensive Evidence Package on Risk Reduction, 15 June 2018, available at: <https://www.pmi.com/investor-relations/press-releases-and-events/press-releases-overview/press-release-details/?newsId=2354720>

² Future of Tax Interim Report, 20 September 2018, available at: <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-interim-report-sep18.pdf>

³ Chapter 10, para 13.

⁴ Chapter 10, para 13.

⁵ Chapter 10, para 13. New Zealand also lags countries such as the UK where smoking rates are falling faster and tax increases are smaller. In the UK, the smoking rate decreased from 20.4% in 2010 to 16.1% in 2016, whereas over the same period, in New Zealand, the rate decreased from 16.7% to 15.5%. New Zealand data based on Health Promotion Agency data, available at: https://www.tcddata.org.nz/HLS%20data/HLS_05.aspx, UK data based on Office for National Statistics, available at:

<https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/drugusealcoholandsmoking/datasets/adultsmokinghabitsingreatbritain>

Current fiscal policy can be improved to deliver a Smokefree 2025

In 2011, in response to the recommendations of a Parliamentary inquiry by the Māori Affairs Select Committee, New Zealand adopted the Smokefree 2025 goal to reduce smoking incidence from 15% to less than 5% of the population by 2025.⁶ PMNZ supports this objective, but notes that progress towards this goal has slowed, at least for certain sectors of the smoking population, and that ASH New Zealand have said New Zealand “*is not on track to meet the Smokefree 2025 goal set by the Government in 2011*”.⁷

Today, 13.8%⁸ of the population continues to smoke, but smoking is significantly more prevalent among certain population groups. Smoking rates amongst Māori are over twice the national average at 32.5 %.⁹ Adults living in the most socioeconomically deprived areas were 3.8 times more likely to be daily smokers than adults living in the least deprived areas, after adjusting for age, sex and ethnicity.¹⁰ Therefore, the heaviest burden of the excise increases have been borne by those who can least afford it and many have continued smoking despite measures to encourage quitting.

The Government currently collects approximately NZD 1.8 billion annually from smokers in tobacco tax.¹¹ Yet despite having one of the highest excise levels on cigarettes within the OECD, and among the most stringent tobacco control regulations in the world, smoking incidence in New Zealand has declined at a slow rate in recent years, as recognised by the Treasury:

*“The effectiveness of excise increases appears to be reducing. Regulatory impact analysis prepared by the Treasury in 2016 indicates that reductions in smoking prevalence are expected to be quite small relative to the size of the increases in the excise rates (Treasury 2016).”*¹² (Page 77)

As many New Zealanders continue to smoke, the Smokefree 2025 goal seems increasingly likely to be missed. While the interim report identified concerns linked to the current tax policy for smoking products, it seems appropriate that the Tax Working Group also considers adjustments to fiscal policy to help reduce smoking in New Zealand much faster, as well as mitigating the unintended consequences of the current tax policy.

Science and innovation can accelerate the decline in smoking rates

Many experts agree that nicotine, while addictive, is not the primary cause of smoking-related diseases.¹³ Instead, it is the toxic compounds that are found in tobacco smoke – most of which are formed when tobacco combusts. Thus, smoke-free products that deliver nicotine without combustion have the potential to reduce individual risk compared to continued smoking.

Decades of scientific research show that eliminating combustion from tobacco can eliminate or significantly reduce the toxicants from tobacco use. Manufacturers have also invested

⁶ New Zealand Ministry of Health, Smokefree Aotearoa 2025, available at: <https://www.health.govt.nz/our-work/preventative-health-wellness/tobacco-control/smokefree-aotearoa-2025>

⁷ ASH (Action for Smokefree 2025), available at: <https://www.ash.org.nz/>

⁸ Indicator: Daily smokers (has smoked more than 100 cigarettes in lifetime and currently smokes at least once a day)

⁹ New Zealand Health Survey, Annual Data Explorer 2017, available at: https://minhealthnz.shinyapps.io/nz-health-survey-2016-17-annual-data-explorer/w_d772768e/w_d772768e/w_ee3e6e42/w_ddb08e56/#/home

¹⁰ New Zealand Ministry of Health, Health an Independence Report 2017, available at: <https://www.health.govt.nz/publication/health-and-independence-report-2017>

¹¹ New Zealand Treasury, Tax Outturn Data Monthly History June 2018, available at: <https://treasury.govt.nz/publications/tax-outturn-data/tax-outturn-data-june-2018>

¹² Future of Tax Interim Report, 20 September 2018, available at: <https://taxworkinggroup.govt.nz/sites/default/files/2018-09/twg-interim-report-sep18.pdf>

¹³ See for example: Royal College of Physicians ('Nicotine without smoke: tobacco harm reduction', available at: <https://www.rcplondon.ac.uk/projects/outputs/nicotine-without-smoke-tobacco-harm-reduction-0>); ASH (Briefing on e-cigarettes, 10 February 2016, available at: <http://ash.org.uk/stopping-smoking/ash-briefing-on-electronic-cigarettes-2/>); National Institute for Health and Care Excellence (NICE) (Tobacco: harm-reduction approaches to smoking, NICE public health guidance no. 45, June 2013, available at <https://www.nice.org.uk/guidance/ph45?unlid=10217539720174221157>); and Public Health England (Britton, J. and I. Bogdanovica, Electronic cigarettes: A report commissioned by Public Health England, available at: <https://www.gov.uk/>)

billions of dollars to develop less harmful nicotine delivery systems designed to appeal to smokers and compete directly with cigarettes. For smokers and their families, smoke-free products represent a much better choice than cigarettes or smoking tobacco. For policy makers, these products represent a new opportunity to help achieve public health objectives and effectively eliminate smoking.

Encouraging smokers, who would otherwise continue to smoke, to switch to smoke-free alternatives, may well be the most effective additional measure the Government can take to accelerate reductions in smoking incidence and reduce the harm caused by smoking. Fiscal policy can play an important role in supporting that transition, as well as its traditional role in encouraging smoking cessation, and reducing initiation.

Philip Morris International – A Smoke-Free solution

The most popular category of smoke-free products in New Zealand is e-cigarettes. E-cigarettes have become increasingly popular in recent years as an alternative product for smokers, aided by an increasingly supportive international evidence base that they are less harmful than smoking cigarettes.¹⁴ We estimate that there are approximately 71,000 regular e-cigarette users in New Zealand.¹⁵

At PMI, we believe that a portfolio of different smoke-free products is essential to achieve a reduction in harm otherwise caused by continued smoking. That is why we are commercializing heated tobacco products as well as e-cigarettes.

Our first smoke-free product available in New Zealand is a heated tobacco product comprising of an electric heating device “IQOS”, used with a specifically designed tobacco product “HEETS”. IQOS heats rather than burns tobacco and generates a nicotine containing vapour that yields on average less than 10% of the levels of harmful constituents found in cigarette smoke.¹⁶ This heated tobacco product is available in over 40 countries and, to date, almost six million adult smokers worldwide have already stopped smoking and switched to IQOS.

While e-cigarettes offer an important alternative, evidence shows that smokers require a portfolio of alternatives to maximize switching. In the UK, a survey from Action on Smoking and Health (UK ASH), estimated that 63% of e-cigarette users returned to smoking.¹⁷ The IQOS tobacco heating system has a very high rate of switching – in other words, approximately 70%-90% of people who buy IQOS use it exclusively or predominantly.¹⁸ This indicates that heated tobacco products are more accepted as a smoke-free product alternative to many smokers. As no single category of smoke-free product will appeal to all smokers, a range of alternatives that smokers find appealing will be necessary to switch New Zealand’s remaining smokers in the shortest possible timeframe.

Several government reports, including from the United Kingdom and Germany, as well as over 20 independent publications confirm that IQOS vapour drastically reduces levels of harmful chemicals compared to cigarette smoke.¹⁹

¹⁴ See for example, Evidence Review of e-cigarettes and heated tobacco 2018, commissioned by Public Health England, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/684963/Evidence_review_of_e-cigarettes_and_heated_tobacco_products_2018.pdf

¹⁵ Kaiser Associates, January 2016, Understanding the Competitive Landscape for E-cigarettes in New Zealand

¹⁶ Average of the reductions in the concentrations (weight per stick) of individual harmful and potentially harmful constituents measured in the IQOS™ aerosol compared to the smoke from a standard 9.4 mg 'tar' reference cigarette (3R4F). Aerosol and smoke collections performed under the Health Canada Intense machine-smoking regime (55 mL puff volume, 2 second puff duration, 30 second interval puff). Reduction calculations exclude nicotine, glycerine and water.

¹⁷ See Figure 2, Use of e-cigarettes (vapourisers) among adults in Great Britain, September 2018, published by ASH UK, available at <http://ash.org.uk/media-and-news/press-releases-media-and-news/ash-news-release-new-data-shows-smokers-are-getting-the-message-on-e-cigarettes/>

¹⁸ Exclusive and predominant use is defined as equal to or more than 70% of an individual's tobacco use is with the IQOS heating device and tobacco heat sticks.

¹⁹ For a full list of independent scientific studies and reports on IQOS see Philip Morris International's Scientific Update, Issue 05, June 2018, available at: https://www.pmiscience.com/resources/docs/default-source/Scientific-Updates/pmi_scientific_update_issue_57684a8852f88696a9e88ff050043f5e9.pdf

“Compared with cigarettes, heated tobacco products are likely to expose users and bystanders to lower levels of particulate matter and harmful and potentially harmful compounds.”²⁰

“...our data confirm absolute values for selected toxicants in the emissions of the analysed HNB that are in agreement with data published by the manufacturer.”²¹

This independent research from around the world helps demonstrate that *HEETS*, alongside e-cigarettes, and other smoke-free products have the potential to play a pivotal role in changing the lives of millions of smokers and make a positive impact on public health.

Advancing New Zealand’s tobacco excise system to support Smokefree 2025

New Zealand does not apply any excise tax to e-cigarettes. Although e-cigarettes are not risk-free, experts agree that they are a much safer option than smoking. Refraining from corrective taxation makes them more affordable, encourages smokers to switch and drives the industry to invest and innovate in this category. We therefore support the current approach.

The current tobacco excise system does not distinguish smoke-free tobacco from smoking tobacco products, as it applies the same rate of taxation to smoke-free heated tobacco as smoking tobacco products, with all categories subject to ‘CPI plus 10%’ annual tax increases. Consistent with the purpose of taxation – to change behaviour and ensure individuals take into account the costs of their behaviour²² – we believe that the level of tobacco taxation should be consistent with a products’ risk profile, and that smoke-free products such as heated tobacco should be distinguished from the most harmful products i.e., smoking tobacco.

Creating a separate excise duty category for heated tobacco

We recommend that a new and separate excise category is created for heated tobacco products to ensure New Zealand’s tobacco system reflects and effectively captures this new category. Excise treatment based on the presence or absence of combustion is consistent with international practice and should be a fundamental component of New Zealand’s future approach to tobacco taxation.

Currently, from an excise tax classification standpoint, heated tobacco products are captured in a ‘catch-all’ category based on customs tariff code under HS 2403.99.90²³. This classification is defined as “Other Manufactured Tobacco” “Other” “Other” and is not defined to clearly accommodate a new growing category of heated tobacco products.

A separate excise category for “*tobacco products intended for inhalation without combustion*” is necessary to properly classify these products and efficiently apply a much lower excise level than smoking tobacco products to encourage consumer switching away from cigarettes. So far, over 20 countries around the world recognize the fundamental distinction between smoking and smoke-free tobacco products. For example, the United Kingdom is in the process of updating its tobacco excise system with the aim to “*help maintain the integrity of the duty system going forward.*” Draft provisions were published in 2018, which explain that:

²⁰ McNeill, A. et al. "Evidence review of e-cigarettes and heated tobacco products 2018." Report commissioned by Public Health England (PHE). February 2018. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/684963/Evidence_review_of_e-cigarettes_and_heated_tobacco_products_2018.pdf.

²¹ Federal Institute for Risk Assessment (BfR). "Levels of selected analytes in the emissions of 'heat not burn' tobacco products that are relevant to assess human health risks." Arch Toxicology. 2018. doi: [10.1007/s00204-018-2215-y](https://doi.org/10.1007/s00204-018-2215-y)

²² See para 10.1 of the interim report.

²³ New Zealand Customs, Excise and Excise-equivalent Duties Table (effective from 1 October 2018), available at: <https://www.customs.govt.nz/globalassets/documents/tariff-documents/the-working-tariff-document-excise-and-excise-equivalent-duties-table.pdf>

“...introducing a new category would give certainty to consumers and producers about the duty heated tobacco products are liable for, reduce complexity in the duty system and ensure that products are captured efficiently.”²⁴

Heated tobacco excise duty

We recommend that the excise duty rate for this new heated tobacco category is set at a much lower rate than for smoking tobacco products to encourage less harmful consumption. Prominent economists focusing on tobacco control and taxation introduced the concept of differential taxation as a tool to maximize incentives for smokers to switch to less harmful products, and also to encourage manufacturers to develop less harmful alternatives. As some of the leading scholars in tobacco control have stated in the New England Journal of Medicine:

“Policymakers should consider an approach that differentially taxes nicotine products in order to maximize incentives for tobacco users to switch from the most harmful products to the least harmful ones.”²⁵

While such a fiscal approach is relatively new to the tobacco sector, it has been successfully applied to other industries. Differential taxation has been used successfully in areas such as mobility (electric motor vehicles) and energy (carbon taxes, leaded and unleaded petrol), as a means to encourage consumers to change behaviour.

Summary of recommendations

In designing the future of tobacco tax in New Zealand, it is important that the overall system supports public health objectives and operates in a fair and coherent manner. A dedicated excise category for heated tobacco products, with a much lower tax rate than smoking tobacco, would help achieve the realisation of New Zealand’s Smokefree 2025 goal. We therefore recommend:

- 1. Create a new heated tobacco product excise tax category and definition.**
- 2. Establish a tax rate for heated tobacco products significantly below the tax rate for all smoking tobacco products.**

²⁴ HM Treasury, Tax Treatment of Heated Tobacco Products, March 2018, available at: <https://www.gov.uk/government/consultations/tax-treatment-of-heated-tobacco-products/tax-treatment-of-heated-tobacco-products>

²⁵ Frank J. Chaloupka, Ph.D., David Sweanor, J.D., and Kenneth E. Warner, Ph.D., Differential Taxes for Differential Risks — Toward Reduced Harm from Nicotine-Yielding Products, *n engl j med* 373;7