

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

REPORT 224

INQUIRY INTO THE COLLECTION OF EXCISE AND DEFERRED CUSTOMS
DUTIES

Australian Government Publishing Service
CANBERRA 1984

c Commonwealth of Australia 1984

Printed by C.J. THOMPSON, Commonwealth Government Printer,
Canberra

JOINT COMMITTEE OF PUBLIC ACCOUNTS

FOURTEENTH COMMITTEE

SENATOR G. GEORGES, (Chairman)

A.G. CADMAN, M.P. (Vice-Chairman)

SENATOR THE HON DAME
MARGARET GUILFOYLE, DBE

SENATOR G. MAGUIRE

SENATOR M. REYNOLDS

SENATOR J.O.W. WATSON

R.J. KELLY, M.P.

L. KENT, M.P.

DR R.E. KLUGMAN, M.P.

H. MAYER, M.P.

F.L. O'KEEFE, A.M., M.P.

P.J. MCGAURAN, M.P.

L.B. MCLEAY, M.P.*

G.F. PUNCH, M.P.

DR A.C. THEOPHANOUS, M.P.

P.N.D. WHITE, M.C., M.P.

*Ex-officio member being Chairman,
House of Representatives Standing Committee
on Expenditure

MEMBERS OF THE SECTIONAL COMMITTEE ON
EXCISE AND DEFERRED CUSTOMS DUTIES

DR A C THEOPHANOUS, M.P. (Chairman)

SENATOR G. GEORGES

SENATOR M. REYNOLDS

R.J. KELLY, M.P.

F.L. O'KEEFE, A.M., M.P.

G.F. PUNCH, M.P.

P.N.D. WHITE, M.C., M.P.

DUTIES OF THE COMMITTEE

Section 8.(1) of the Public Accounts Committee Act 1951 reads as follows:

Subject to sub-section (2), the duties of the Committee are:

- (a) to examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of section 50 of the Audit Act 1901;
- (aa) to examine the financial affairs of authorities of the Commonwealth to which this Act applies and of intergovernmental bodies to which this Act applies;
- (ab) to examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- (b) to report to both Houses of the Parliament, with such comment as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Parliament should be directed;
- (c) to report to both Houses of the Parliament any alteration which the Committee thinks desirable in the form of the public accounts or in the method of keeping them, or in the mode of receipt, control, issue or payment of public moneys; and
- (d) to inquire into any question in connexion with the public accounts which is referred to it by either House of the Parliament, and to report to that House upon that question,

and include such other duties as are assigned to the Committee by Joint Standing Orders approved by both Houses of the Parliament.

**INQUIRY INTO THE COLLECTION OF EXCISE AND DEFERRED
CUSTOMS DUTIES**

CHAPTER	PAGE
Preface	(ix)
1. Introduction	1
2. Recommendations	6
General Management Strategy	6
Distilled Spirits	7
Beer	8
Tobacco	8
Bonded Warehouses	9
Petroleum Products	10
Diesel Fuel	10
Petroleum Products Freight Subsidy Scheme	10
3. General Management Strategy	12
Background	12
The Auditor-General's Recommendations on General Management and the Departmental Response	12
Strategic Planning	14
Independent Validation of Production Quantities	16
The Point at which Excise is Collected and the Treatment of Losses	18
Risk Management	20
Systems Based Investigation Techniques	21
Training	22
Staffing Levels	23
4. Distilled Spirits	25
General Background	25
The Auditor-General's Comments	27
Departmental Response	30
Industry Views	32
Sales Tax vs Excise	38
The Committee's Comments and Recommendations	46
5. Beer	52
General Background	52
The Brewing Process	52
The Auditor-General's Comments	54
Departmental Response	56
Industry Response	58
Audit's Response to Industry Criticism	60
The Committee's Comments and Recommendations	61

6.	Tobacco	65
	General Background	65
	The Tobacco Industry	66
	The Auditor-General's Comments	67
	Departmental Response	69
	Industry Response	71
	The High Court Cases of 1969 and 1973	72
	Speculative Clearances of Products Prior to the 1983 Budget	73
	The Committee's Comments and Recommendations	
7.	Bonded Warehouses	79
	General Background	79
	Approved Places (excisable goods)	80
	Customs Warehouses (imported goods)	84
	Findings of the Auditor-General's Efficiency Audit Report and the Departmental Response	86
	Comments from the Auditor-General's September 1983 Report and the Departmental Response	88
	Alternatives to the Bonded Warehouse System	90
	Industry Response	90
	The Committee's Comments and Recommendations	
8.	Petroleum Products	94
	General Background	97
	Auditor-General's Comments	98
	Departmental Response to the Efficiency Audit Report	99
	Industry Response	102
	The Committee's Comments and Recommendations	
9.	Diesel Fuel	107
	General Background	109
	The Committee's Comments and Recommendations	
10.	Petroleum Products Freight Subsidy Scheme	111
	General Background	113
	The Committee's Comments and Recommendations	
Appendix 1	Details of the Department's Overall Strategy for Achieving Aims and Objectives	115
Appendix 2	Submissions on the Proposal to Collect Excise Revenue as Sales Tax	118

Appendix 3	Submission by the Department of Industry and Commerce on the Auditor-General's Comments on Warehousing in his September 1983 Report	127
Appendix 4	Possible Alternatives to the Existing Bonding System	134
Appendix 5	Banksmeadow Pipeline Metering System	152

PREFACE

This report outlines the findings of the Committee's inquiry which was based on the Auditor-General's Efficiency Audit Report into the collection of excise duties and deferred customs duties. The Auditor-General reported in March 1982 on the systems employed by the then Department of Business and Consumer Affairs, now Industry and Commerce, in the collection of:

- . excise duties on beer, spirits, tobacco and petroleum;
- . customs duty on imported goods held in licensed warehouses; and
- . diesel fuel tax payable under the terms of the then scheme when fuel purchased duty free was subsequently used for a dutiable purpose.

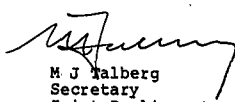
The audit undertaken by the Auditor-General was designed to establish whether the operation of the control systems used by the Department efficiently and effectively collected revenue due to the Commonwealth. The audit also made suggestions for improvements in operations where these were deemed necessary.

The Committee commenced its inquiry in 1982, however action was interrupted by competing inquiry activities and an election early in 1983. The Committee's inquiry paid considerable attention to the Department's operations in the area subjected to Audit's scrutiny and also to the suggestions made by Audit both from the Department's and industry's point of view. In addition, the Committee also considered the operation of the petroleum products freight subsidy scheme.

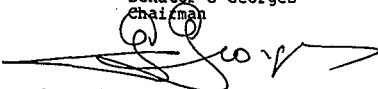
The Committee was informed by a senior representative of the Department that it was extremely worthwhile to have had the Audit Office examining the Department's administration of this complex control system. While the Committee does not agree with all the comments and recommendations made in the Auditor-General's Report, there is considerable merit in the overall conclusion that while the principle of using producers' own information is a satisfactory approach, increased attention and effort should be devoted to ensuring accuracy and security in this area of significant of revenue collection.

The Committee wishes to thank the staff of its secretariat and acknowledge the unstinted co-operation given by officers of the Department of Industry and Commerce and representatives of the industries concerned. For and on behalf of the Committee,

Senator G Georges
Chairman



M J Halberg
Secretary
Joint Parliamentary Committee of Public Accounts
Parliament House
CANBERRA ACT 2600
3 October 1984



CHAPTER 1

INTRODUCTION

1.1 This inquiry was based on the concerns expressed in the 'Auditor-General's Report on an Efficiency Audit - The Collection of Excise and Deferred Customs Duties' of March 1982. In that Report the Auditor-General examined the procedures used by the then Department of Business and Consumer Affairs (now Industry and Commerce) in the collection of excise on beer, tobacco and tobacco products, potable spirits, and petroleum products. The efficiency audit also looked at the operation of the bonded warehouse system which is used for deferring customs duties. The aim of the Auditor-General's efficiency audit was to check that controls and procedures used are adequate to protect the Commonwealth Government's revenue.

1.2 The system used by the Department of Industry and Commerce for excise collection and verification is known as 'commodity control'. Under this system the Department relies on producers' returns for data on the amount of excisable production of each commodity. Audit was satisfied that the principle of commodity control was sound so long as the Department carried out sufficient, rigorous, validating checks of the producers' returns and accounts. In fact it was in this area of validating checks that Audit found deficiencies. Audit's main suggestions for improvement were in the following areas:

- development of risk management operating philosophies;
- development of independent and secure measurement systems at the earliest possible points in the production processes to establish the volume of dutiable products and therefore potential revenue due;
- the direction of field checks toward proving the adequacy of companies' own control systems rather than detection of clerical errors;
- the effectiveness measurement system used by the Department to provide cost benefit feed-back information on any changes made to control procedures and systems; and
- the identification and use of independent data on production, product sales or raw material inputs, to validate the production volumes given on returns.

1.3 More detailed recommendations were also made under the following subject headings:

- . Management System;
- . Beer;
- . Spirits;
- . Tobacco;
- . Petroleum products;
- . Diesel fuel;and
- . Bonded warehouses.

1.4 The Committee decided to take up this inquiry so that it could examine Audit's concerns in detail. The following terms of reference were decided upon:

- . review the comments of the Auditor-General in his Report on an Efficiency Audit - The Collection of Excise Duties and Deferred Customs Duties (Efficiency Audit Report No. 4) within the context of:
 - cost effectiveness of the Auditor-General's recommendations;
 - reaction of the Department of Industry and Commerce; and
 - reaction of private industry to the Auditor-General's recommendations and conclusions.
- . monitor the implementation of the Auditor-General's recommendations within the Department of Industry and Commerce and within private industry;and
- . review of effectiveness and efficiency of departmental policies in carrying out the collection of excise duties and deferred customs duties.

1.5 The terms of reference were later extended to include consideration of the petroleum products freight subsidy scheme, which is also administered by the Department of Industry and Commerce.

1.6 At this point it may be useful to outline briefly the role and significance of excise as a form of taxation. In Australia we understand excise to mean a tax applied solely to certain goods manufactured in Australia.

1.7 Historically, the introduction of excise in many countries was justified on moral grounds, to discourage the use of goods considered socially undesirable (eg spirits, beer and tobacco). Two centuries ago David Hume used the following words to describe commodity taxation:¹

'The best taxes are such as are levied on consumptions, especially those on luxury; because such taxes are least felt by the people. They seem, in some measure, voluntary; since a man may chuse (sic) how far he will use the commodity which is taxed. They are paid gradually, and unsensibly: They naturally produce sobriety and frugality, if judiciously imposed: And being confounded with the natural price of the commodity, they are scarcely perceived by the consumers.'

1.8 In practice however, the imposition of excise on some of these commodities does not greatly influence levels of consumption. It is this very characteristic which makes excise on these commodities, a convenient form of tax. Price increases tend not to lead to significant decreases in consumption and therefore to reductions in excise revenue (ie some of these commodities have low price elasticities of demand). Recent experience in the spirits area however, has shown that consumption of potable spirits can be quite responsive to variations in price (or increases in excise). The response to the 1978/79 Budget increases in excise on potable spirits illustrated this point. It is difficult however to determine whether any price - induced decrease in consumption of potable spirits leads to a decrease in total alcohol consumption or a shift to consumption of other forms of alcohol.

1.9 In Australia excise is levied on only a few commodities eg beer, tobacco, spirits, petroleum products and crude oil. Nevertheless it is a very important source of revenue for the Federal Government which has exclusive power over commodity taxation by virtue of Section 90 of the Constitution. In 1983/84 net excise revenue from the commodities being considered in this inquiry was \$4,083 million representing approximately 9% of total Commonwealth tax revenue. The components are shown in Table 1.1.

1.10 Excise revenue in 1983/84 compares with approximately \$2,400 million revenue derived from customs duties on imports, over the same period.

¹ D Hume, 'Of Taxes' (1752) Reprinted in David Hume, Essays Moral, Political and Literary, ed T H Green and T H Grose, Longmans, London, 1875, vol. 1 p. 358.

TABLE 1.1 EXCISE REVENUE FROM THE COMMODITIES UNDER CONSIDERATION

Commodity	Excise Revenue		
	1982/83 \$million	1983/84 \$million	1984/85 Estimate \$million
Beer	1123	1159	1212
Potable Spirits	114(a)	118	113 (c)
Tobacco Products	799	864	906
Petroleum Products(b)	1293	1973	2151
Other (inc. credits)	-9	-31	-31
TOTAL	3320	4083	4352

(a) Includes fortifying spirit

(b) Includes fuel oil, heating oil, kerosenes.

(c) Net of revenue of about \$5m collected as excise on fortifying spirit in 1983/84 which is to be refunded in 1984/85.

Source: 1983/84 Budget Paper No. 1.

1.11 In carrying out its inquiry the Committee took note of the criticism by some sectors of industry that during the Efficiency Audit there had been no consultation with industry and the audit had been concentrated in Sydney. Consequently the Committee's inquiry strategy was designed to ensure that the sectors of industry affected by the recommendations of the Efficiency Audit would have every opportunity to put their views, either directly to the Committee or by submission.

1.12 The Committee's inquiry strategy was as follows:

- interested companies and industry organisations were invited to make submissions;
- advertisements were placed in all major daily and some weekly newspapers calling for submissions from the public;
- inspections were made of production processes in each of the commodity areas under investigation as well as several bonded warehouses;

- a submission commenting on the conclusions and recommendations in the Auditor-General's Report was sought from the Department;
- the Committee held public hearings at which witnesses from the Department of Industry and Commerce were examined;
- a series of further written requests for information and clarification was made to the Department following on from evidence given at the public hearings; and
- the Committee was briefed by Mr B. Creenaune of Touche Ross and Co., Chartered Accountants, on the 'systems based investigation techniques' which are being introduced into the Department's repertoire of investigative tools.

1.13 In addition to the above, the Committee had access to, and drew upon, the Department's own report on an internal review of Inland Services' activities carried out in 1977/78.

1.14 The material collected in this way was analysed by the Committee and forms the basis of this Report.

CHAPTER 2

SUMMARY OF RECOMMENDATIONS

This Chapter reproduces, in a consolidated form, all the recommendations made by the Committee. These are cross-referenced by page number to their location in the text. The recommendations, summarised below, should be considered in conjunction with the supporting material and the Committee's other comments which are to be found in the relevant chapters. It should be noted that the Committee does not envisage a large increase in the overall staffing resources being required as a result of these recommendations. Rather it considers that these initiatives could be largely handled with the redeployment of resources at their current level.

General Management Strategy (Chapter 3)

1. The Department begin work immediately on a detailed plan which translates overall objectives into specific operational processes. The plan should facilitate co-ordination, permit systematic review of options and assist in the formulation of timely and detailed strategies for the improvement of excise collection procedures. The results of these routine investigations should feed back into current operations and the plan itself. Within this framework, attention should be paid to the role and influence of State Collectorates. (p. 16)
2. Customs undertake and document in detail a comprehensive examination of the possibilities for using independent data sources in the validation of declared production quantities of excisable commodities. (p. 17)
3. The excise collection system proposed in Chapters 5, 6 and 8 serves as an example of the options to be considered in a detailed examination of alternative methods of excise collection aimed at streamlining arrangements and increasing security over dutiable product. (p. 19)
4. Computing and staff resources be made available to allow the immediate implementation of a national risk assessment program and that resource allocation decisions be made by Central Office on this basis. (p. 20)

5. The numbers of officers who have undergone adequate training and the numbers still requiring training in specified skills be monitored by Central office. (p. 22)
6. The Department undertake, as a matter of urgency, a comprehensive review of staffing requirements in Central Office and the States. The key issue which should be considered in this review is the level of staffing required in the various Customs offices to protect adequately the revenue collected through those offices. (p. 24)

Distilled Spirits (Chapter 4)

7. Urgent attention be given to increasing powers exercised by officers under the Excise Act to make them comparable to those exercised under the Customs Act, particularly regarding the powers of access to documents. The Committee recommends that care be taken to safeguard civil liberties and to prevent the possible abuse of powers. (p. 47)
8. A national loss control strategy for spirits be developed and implemented as a matter of urgency. (p. 49)
9. The Committee reiterates the recommendation of the National Loss Control Working Party that consideration be given to a simplified approach to loss control, involving an adjustment for losses being given in the duty levied. (p. 49)
10. The Committee agrees with the views of the Distilled Spirits Industry Council and recommends that spirits bottling only be permitted on licensed premises which are subject to control by the Department. This would eliminate one category of operator, and should reduce the risk of illegal extension of duty-paid spirit with duty-free spirit. (p. 50)
11. Departmental resources be applied to ensure proper surveillance and investigation of end users of pure alcohol sold excise-free for industrial, scientific and educational applications. (p. 50)

12. The Committee supports the Department's announcement that a review of their spirits operations is currently being undertaken. The Committee recommends that this review be comprehensive and that sufficient Departmental resources be allocated to allow it to be completed urgently. The review should pay particular attention to the control of fortifying spirit as well as excise-free spirit used in other applications. (p. 51)

Beer (Chapter 5)

13. Customs readdress the Auditor-General's recommendations on the possible use of independent sources of data to develop a means of estimating potential revenue due. (p. 63)
14. Adequate resources be made available to the Inland Revenue and Dumping Division to enable prompt implementation of systems based reviews in the brewing industry. (p. 64)

Tobacco (Chapter 6)

15. The Department devote greater effort to the identification and use of alternative sources of data on production volumes in order to estimate the excise revenue due from tobacco products. (p. 74)
16. Adequate resources be made available to increase the rate of progress in the development of systems based investigation techniques in the tobacco industry and to allow regular review of companies' systems. (p. 74)
17. The introduction of a computerised inventory control system, such as TABS, to enable proper inventory control of under-bond goods by Customs. In the case of tobacco products, effective implementation of this system would require declaration to Customs of the quantities of excisable manufactured products and imported products moved into licensed warehouses. Such a system could also monitor all product movements under bond. This recommendation would need to be modified if the point of excise collection were moved. (p. 75)
18. The Department assess:

the cost in time of imposing the controls;
and

overseas experience of, and possible alternative systems for, prevention of this type of speculation. (p. 78)

19. Where unusually high clearances of excisable products occur immediately prior to the imposition of quota controls, a detailed investigation of the circumstances be undertaken and the results be reported to the Minister. (p. 78)

Bonded Warehouses (Chapter 7)

20. There be a formal "entry into bond" for domestically produced excisable goods with documentation and control comparable to that exercised over imported goods under bond. (p. 91)
21. The Committee considers that the Department's control procedures for bonded warehouses lack sophistication and that better use could be made of ADP facilities in this area. The Committee recommends that immediate attention be given to upgrading control systems for bonded warehouses. (p. 91)
22. Customs promptly develop and implement a computer system which reconciles bond entries and releases to provide sufficient information to allow proper inventory control in bonded warehouses. (p. 92)
23. The Committee endorses the Auditor-General's recommendations that Customs should analyse dwell times of goods under bond and direct investigative efforts to those goods with apparently lengthy dwell times. Similar comments apply to Audit's suggestion that efforts should be concentrated towards those warehouses which yield the greatest revenue. (p. 92)
24. Customs examine the benefits to be gained from effectiveness surveys, correct the methodological problems experienced with the warehousing survey and proceed with further surveys as soon as possible so the results can be used as management aids. (p. 92)
25. The perceived need for the bonded warehouse system should be re-examined, including the implications of abolishing or modifying the system. The Committee considers that this issue should be referred to the Industries Assistance Commission (IAC) for inquiry. (p. 93)

Petroleum Products (Chapter 8)

26. Customs seek sources of independent data to allow checks of revenue due against revenue collected. Estimates should be made against crude oil input figures and any available sales or usage figures. (p. 106)

Diesel Fuel (Chapter 9)

27. The Department review the effectiveness of the administration of the diesel rebate scheme. (p. 109)

Petroleum Products Freight Subsidy Scheme (Chapter 10)

28. The Committee concludes that abuses of the Petroleum Products Freight Subsidy Scheme are not under control and the deterrents are inadequate. The Committee recommends:

- . immediate substantial increases in penalties;
- . the freeing of more resources from other areas for transfer to investigation work in this area; and
- . the application of ADP resources to the administration, control and monitoring of the freight subsidy scheme. (p. 114)

29. A comprehensive review of the Petroleum Products Freight Subsidy Scheme be undertaken within a year of the introduction of the other recommendations. The review should include consideration of:

- . the extent of abuses and their revenue implications;
- . the costs of administering the scheme as well as the costs of increasing surveillance and investigation to plug the apparent gaps;
- . means of streamlining procedures and requirements to minimise opportunities for abuse;

- the implications, cost and benefits of abolishing the scheme; and
- alternate ways of achieving the intended outcome. (p. 114)

CHAPTER 3

GENERAL MANAGEMENT STRATEGY

Background

3.1 The Australian Customs Service is currently a part of the Department of Industry and Commerce. The State Customs Collectorates and Sub-Collectorates have the direct operational responsibility for the collection of excise and the control of bonded premises.

3.2 Within the Central Office of the Department, responsibility for the planning and coordination of strategies for the collection of excise and deferred customs duties rests with two branches in the Inland Revenue and Dumping Division. These are, the 'Inland Services Branch' and the 'Resources Excise and Bounties Branch'. The Inland Services Branch looks after all the traditional excisable commodities other than energy related products. This branch and the State counterparts are sometimes referred to collectively as Inland Services in this report.

3.3 This Chapter deals with those general problems within the Department of Industry and Commerce and the Australian Customs Service which are common to the management of several of the commodities under consideration by this inquiry. In this respect the Committee's report roughly follows the organisation of the Efficiency Audit Report which also looked at general management issues separately from each commodity area.

3.4 The Committee identified a number of general management issues, some of which had been raised by the Efficiency Audit Report, some by the 1978 internal Management Review of Inland Services operations, as well as other issues. These issues are dealt with under separate sub-headings later in this chapter.

The Auditor-General's Recommendations on General Management and the Departmental Response

3.5 The Concluding Summary of the Efficiency Audit Report¹ contained the following recommendations on the Inland Services' management system:

- (i) Central Office should assess industry-wide production and distribution systems for each commodity with a view to establishing possible revenue gaps and opportunities for evasion and use the results to set out national control programs.

1 Australia, Parliament, Report of the Auditor-General on an Efficiency Audit: the Collection of Excise Duties and Deferred Customs Duties by the Department of Business and Consumer Affairs. Parl. Paper No. 70/1982, p. 11-12.

- (ii) Central Office should create and monitor a consistent and comprehensive risk management system for use by Collectorates.
- (iii) Central Office should review the points of measurement of product within the production processes to ensure the full accountability of producers for revenue due.
- (iv) The face value of penalties should be reviewed.'

3.6 Several further recommendations were made in Appendix 1¹ of that Report:

- Central Office should establish and maintain a system to monitor performance, to review changing risk factors and to ensure cost-effective allocation of investigation resources
- Collectors should establish similar risk management procedures as well as investigation systems according to guidelines set by Central Office. These investigation systems should be systems-based aimed at validating firms' reporting systems and checking points of revenue risks, and
- there is a need to independently assess with some confidence the full potential revenue due so that it may be compared with revenue received and form an integral part in the assessment of risk.'

3.7 Audit also endorsed the conclusions of the internal Departmental review of Inland Services, carried out in 1977/78. In particular, Audit reiterated the importance of effectiveness measurement:²

'Central Office would be expected to be able to justify the level of resources used in each Collectorate through a control process relating program objectives and performance effectiveness measures to resource needs.'

3.8 The Department responded differently to each of the recommendations. Overall however, progress has been disappointing. In this Section the Department's responses are indicated briefly. More detailed Committee comment is made in the following sections dealing with specific issues.

3.9 Progress with industry reviews has been very slow. After completion of the tobacco industry review in 1983 the program was delayed while attention was concentrated on the development of systems based investigation techniques. In May 1984 the Department announced that it was conducting a review of the spirits area. The program for completion of other industry reviews has not been available.

1 Efficiency Audit Report, op. cit., p. 36.
 2 ibid., p. 37.

3.10 In fact Customs has been directing considerable effort into developing and testing a systems based investigation methodology aimed at validating firms' reporting and control systems and checking points of revenue risk. The consultant Touche Ross and Co. is being used extensively in this process.

3.11 The recommendation on the introduction of a national risk management system was accepted by the Department and work has been proceeding on the development and trial of a system across several States. The Department claims that commodity risk management policies will evolve when information starts flowing from systems based investigations of individual companies. The Department also claims that Audit's concerns about effectiveness measurement will be accommodated by the risk management system.

3.12 Some consideration has been given to the points of measurement of product for beer and tobacco but any changes were ruled out. The recommendation on penalties was accepted by the Department and penalties have been revised.

Strategic Planning

3.13 The Committee is concerned about the Department's overall approach to the improvement of its management and control systems. The concern stems from what the Committee perceives as insufficient attention to careful, detailed, strategic planning and priority setting.

3.14 In a submission presented to the Committee on 21 September 1983, the Department provided a list of the aims and objectives of the Inland Services control program.¹ At the public hearing on 21 September 1983 the Committee questioned Departmental representatives about the overall strategy for achieving these aims and objectives.² Following that hearing further clarification was sought from the Department on this matter.

3.15 A two page response was provided on 8 September 1983 and is reproduced at Appendix 1. In this response the Department argues that a timetable of activities has not been set because of the importance of maintaining a flexible approach. The paper nevertheless does identify several so called 'short term objectives', including

'the development of a national training program in conjunction with State Officers; the means to improve investigation techniques particularly in the area of computerised record keeping; the maintenance of uniform cost-effectiveness data by State Officers; an effectiveness review of warehousing operations; commencement of industry reviews beginning with the tobacco industry.'

1 Joint Parliamentary Committee of Public Accounts, Inquiry into the Collection of Excise and Deferred Customs Duties, Minutes of Evidence, p. 376-377.

2 ibid., p. 403-422.

The Department appears to have concentrated on the development of a risk management system and the introduction of systems based investigation techniques. While these tools are important, they are not sufficient in themselves.

3.16 It appears to the Committee that Departmental efforts have been too heavily concentrated on developing the systems based investigation techniques with very little progress in the other areas identified. For example:

- tobacco is the only commodity for which an industry review has been completed;
- progress on the introduction of a national risk management system has been very slow;
- an effectiveness review of warehousing was carried out but the Department now states that the methodology was faulty and no use has been made of that review and no further work has been carried out in this area; and
- work on the training program has been proceeding without an overall assessment of training needs or achievements (this was only tackled after the Committee asked for details).

3.17 The Department commissioned the consultants Touche Ross & Co to undertake two reports entitled 'A Review of Excise Investigation Techniques' and 'Modern Excise Investigation Practice'. These were completed in the middle of 1982. In the first of these reports Touche Ross states that

'The Inland Services Branch needs to formulate a detailed management plan which is capable of implementation in a medium term planning frame of say three years.'

Touche Ross actually prepared a 'first draft plan'. The Department however, did not proceed with this management plan choosing instead to devote resources to a pilot study using systems based investigation techniques which were also suggested by Touche Ross & Co. To the Committee's knowledge the draft management plan has not as yet been taken up.

3.18 Inland Services also appears to have difficulties with the development and rigorous evaluation of options/policies for control strategies. Issues seem to be dealt with on an ad hoc basis as they arise rather than being tied into the development of an overall plan.

3.19 The inquiry cast some doubts on Central Office's ability to plan and coordinate strategies centrally, because of the difficulties it appears to have in exerting control over State Collectorates. The 1977/78 internal review of Inland Services drew attention to this problem. Although this difficulty has been somewhat alleviated with the increased staff numbers in Central Office it seems that the problem persists.

3.20 The Committee is concerned at the length of time it seems to take the Department to respond to changes and to suggestions for improvements. Commodity control was introduced during the 1960s. There appears to have been ample time for Customs to identify and implement control requirements under this system, but it seems that this was only just starting to happen in 1983. Similarly the internal review of Inland Services was complete in 1978 and it seems that many of the recommendations have not yet been acted on. The Committee considers that more attention within the organisation to setting objectives and priorities and strategic planning, might assist with this problem.

3.21 In summary, evidence provided by the Department suggests inadequate detailed planning to further the broad objectives which have been identified. It is the Committee's view that while objective setting is extremely important, it is of limited use if no plan of action is devised to match. Identification of priorities also seems to need further work.

1. The Committee recommends that the Department begin work immediately on a detailed plan which translates overall objectives into specific operational processes. The plan should facilitate co-ordination, permit systematic review of options and assist in the formulation of timely and detailed strategies for the improvement of excise collection procedures. The results of these routine investigations should feedback into current operations and the plan itself. Within this framework, attention should be paid to the role and influence of State Collectorates.

Independent Validation of Production Quantities

3.22 A major problem with the current excise collection procedures is that without independent statistical data on production quantities, the Department can never be confident that its control strategies are effective because it cannot estimate the revenue due and compare it with revenue collected.

3.23 Despite several requests the Committee did not see evidence that the Department had undertaken a detailed study of the possibilities of using independent data sources for obtaining even 'order of magnitude' estimates of production and hence excise revenue due.

3.24 In a supplementary submission to the Committee, following the June 1982 public hearings, the Department indicated that a preliminary investigation of the possibility of using Australian Bureau of Statistics (ABS) data for the independent validation of production volumes had not yielded any positive results. In a later submission (dated 12 August 1983)¹ the Department referred back to that investigation calling it 'a detailed examination'. When questioned about this discrepancy at a public hearing in September 1983² the Departmental representative discussed the unsuitability of ABS data for this purpose but indicated that further work was being carried out.

3.25 The Committee is not convinced that sufficient effort has been directed to this area and suspects that for some commodities, ABS and/or other statistics could be used to obtain approximate figures, once allowances were made for factors such as time lags or duty-free components. The Committee is not necessarily concluding that more work was not done by the Department. However, the Committee despite several attempts, was unable to extract the documentation covering the study from the Department.

3.26 The Committee appreciates that there may be some shortcomings associated with ABS figures. A more useful independent source would be to consider production data. Firms no doubt monitor their production processes by comparing actual and expected outputs from known inputs. The Committee considers that the Department should devote more attention to this avenue and incorporate it in their systems analysis.

3.27 The Committee also suspects that there may be insufficient emphasis in the Department on the maintenance of proper documentation on the background and basis on which decisions are made. Such documentation is fundamental to an efficient operation. Without proper records, work may have to be repeated when staff changes occur or when personal recollections fade.

2. The Committee recommends that Customs undertake, and document in detail, a comprehensive examination of the possibilities for using independent data sources in the validation of declared production quantities of excisable commodities.

1 Minutes of Evidence, op. cit., p. 387.
2 ibid., p. 445-446.

The Point at which Excise is Collected and the Treatment of Losses

3.28 The Committee gave considerable thought to possible modifications of the excise system, particularly the possibility of changing the point at which excise is collected and the manner in which losses are handled. These issues are covered in detail for each of the affected commodities in the chapters dealing with those commodities. At this stage however, it may be useful to outline in broad terms the principles concerned.

3.29 Under present arrangements, excise is payable upon entry of goods into home consumption. For a large proportion of excisable goods this takes place only after the goods have been transported or stored for some time under bond. When goods are released from bond they are entered into home consumption and excise duty is paid. Bonding essentially provides a means of deferring excise payment until shortly before the point when the excise paid can be recouped through sale of the product. The same outcome could be achieved by means of an earlier point at which duty is collected combined with more generous credit arrangements for payment.

3.30 One approach considered by the Committee was moving the point at which excise is collected back towards the end of the production process for beer, tobacco products and petroleum products. The proposal would reduce under-bond movement and storage of these excisable products and replace this arrangement with an extension of the settlement period for the payment of excise.

3.31 The main advantage of such an adjustment to the system would be that the length of time during which the products need to be under Customs control would be decreased. This should reduce the risk of diversion of product prior to duty payment as well as reduce the Customs manpower resources required to control these products. This should free up resources for use in other, higher priority areas.

3.32 The main disadvantage of such a proposal would be the cost, to the producers, of financing earlier excise payments. An appropriate extension to the settlement period for excise payment could compensate for this cost. The extension would need to be based on an estimate of the average length of time that the various commodities stay under bond.

3.33 The Committee appreciates some of the practicalities associated with implementation of the proposal, particularly the new administrative procedures that would be required to account for duty-free sales, exports, losses and the varying impact on revenue and working capital that such measures might impose. The Committee also notes that the measures and records which would be required for assessment and collection of excise at the earlier points (identified in the relevant chapters on

individual commodities) are already made by firms and in most cases submitted to Customs. The proposal may streamline procedures by eliminating some of the steps in the present arrangements and, in some cases, reducing the number of premises needing to be supervised. The Committee is not in a position to recommend firmly such a modification in the excise collection procedures. However it considers that possible alternative methods of excise collection, such as this one, should be given careful consideration by the Department of Industry and Commerce and other appropriate departments in consultation with industry.

3.34 During the Committee's examination of this issue, the associated problem of how to handle reimbursement of excise paid on product losses which occur after the point of excise collection, also emerged as requiring attention. The Committee considers that under the present arrangements too much effort is directed to the documentation and validation of product losses both by Customs and by excise paying firms. The Committee is anxious to ensure that further efforts are not wasted in this area as a result of the proposal to move the point of excise collection.

3.35 Since losses constitute a relatively small proportion of total excise liability care needs to be taken to ensure that a disproportionate amount of time and effort is not put into this area. An alternative approach should be devised which yields the same amount of revenue but eliminates the need for extensive validation and surveillance.

3.36 The Committee suggests (see chapters on individual commodities) that a more cost-effective approach would be to make an automatic fixed percentage adjustment to the assessed quantity of excisable product in the calculation of excise liability. The adjustment for each commodity would be based on historical loss data over several recent years. The advantages of this approach would be that the need for validating losses would be eliminated and firms would have a financial incentive to minimise losses (the firms who managed to reduce losses below the adjustment percentage would gain a net financial advantage). The adjustment percentage would need to be determined by the Department in close consultation with the affected industries. This issue is covered in the recommendations associated with each commodity in later chapters of this report.

3. The Committee recommends that the excise collection system proposed in Chapters 5, 6 and 8 provide the basis for detailed examination of alternative methods of excise collection aimed at streamlining arrangements and increasing security over dutiable product.

Risk Management

3.37 In the Efficiency Audit Report¹ the Auditor-General stressed the importance of a nationally coordinated risk management program to enable Customs to maximise the effectiveness of its control procedures by concentrating investigative resources in areas of greatest risk to revenue. This approach was also supported by the 1978 internal review. Audit's concern was that at the time of the Efficiency Audit, risk assessment of firms was only being carried out at the Collectorate level and separately for each commodity. This did not allow the national coordination of resource allocation according to risks to revenue.

3.38 At the hearing on 7 May 1984 the Department advised² that a 'standard premise risk rating form' has been developed and that the risk management program is now proceeding in Queensland, New South Wales, Victoria, South Australia and Western Australia. The program is concentrating on 15,000 premises in the warehousing area. Extension to other areas is planned for sometime in the future. The Department also advised³ that the Inland Services Branch was seeking a microcomputer to record and analyse the results of State investigations of premises to replace manual data processing of the results of risk management programs and cost effectiveness figures.

3.39 While the Committee welcomes the fact that some progress is being made in this area it is extremely disappointed that the advances have been so slow and so limited. Basically the approach seems to have been to develop a set of guidelines and leave it to each State to apply them. The guidelines developed so far are apparently only for warehouses. In the Committee's view, this is only a very minimal advance on the situation brought to our attention by Audit at the beginning of 1982.

3.40 The Committee considers that the risk assessment program (and therefore resource allocation) should be operated by Central Office on a national basis. This clearly requires the system to be computerised to allow Central Office to coordinate inputs from States and to make decisions about relative investigation staffing levels across Collectorates and Sub-Collectorates throughout Australia as well as across commodities. The Committee hopes that the microcomputer which is being sought is intended for this purpose.

4. The Committee recommends that computing and staff resources be made available to allow the immediate implementation of a national risk assessment program and that resource allocation decisions be made by Central Office on this basis.

1 Efficiency Audit Report, op. cit., p.32.
2 Minutes of Evidence, op. cit., p. 516.
3 ibid., p. 520.

Systems Based Investigation Techniques

3.41 Customs collects excise duties by means of a system known as 'commodity control'. Under commodity control the quantity of excisable product produced and the duty liability is assessed and declared to Customs by the producing company. In other words Customs relies on the companies' production figures. Customs has access to company documentation and accounts. Various checks are made on these accounts to try to validate the declared production figures.

3.42 The Committee agrees with Audit's view that Customs should put more effort into systems based investigations aimed at validating firms' own reporting and control systems to ensure that these are adequate for the protection of Commonwealth revenue. This process, sometimes described as 'systems auditing', basically involves checking the company's own controls to identify points of risk to revenue. Where a company's operations are largely computerised, computer audit software packages are used in the process.

3.43 As discussed in Chapter 6 the Department commissioned Touche Ross and Co to carry out a pilot exercise on one of the cigarette manufacturers to demonstrate the use of systems based investigation techniques. Following the success of that exercise Touche Ross drew up a four phase consultancy program which ran between October 1983 and March 1984. It was designed to provide Customs with systems based and ADP auditing skills. The program consisted of:

- Phase I - initial training of ten officers in ADP concepts and systems based auditing;
- Phase II - first round of four on-the-job field investigations including investigation of another tobacco company;
- Phase III - further training in management accounting, software review and evaluation of Phase II case studies; and
- Phase IV - second round of on-the-job field investigations.

3.44 In May 1984 the Department advised that three phases had been completed and it was working on Phase IV of the program,¹ which would cover a brewery, a distillery and a licensed petroleum installation. A program of investigations had also been drawn up for all States for the remainder of 1984.

3.45 Systems based investigation is clearly a very important technique in the collection of excise, and the Committee is encouraged to see it being developed with some impetus. While the Committee recognises the importance of this

¹ Minutes of Evidence, op. cit., p. 518.

approach, it does consider that the Department has been relying too heavily on this single investigative tool to the detriment of other areas and methods which also require attention. These are identified throughout this report.

Training

3.46 The 1978 internal review of Inland Services highlighted the importance of training officers in investigative techniques and suggested that this area had been neglected and that there had been too much emphasis on industry and departmental knowledge.

3.47 In response to discussions at the June 1982 public hearings, on 16 September 1982 the Department provided details of what was described as a draft of 'The Department's Training Package' which was to be run as a pilot course, evaluated and introduced early in 1983. No evidence of training in investigative techniques appeared in this draft.

3.48 In September 1983 the Department advised¹ that the pilot course had been run in Melbourne in November/December 1982. In January 1984 the Department advised that the standardised course on Inland Revenue had now been developed and had been conducted in Brisbane and Melbourne in November/December 1983. In mid 1982 the introduction of the course was programmed for early 1983 and in the event it did not take place until the end of 1983. This delay may either be interpreted as evidence of the Department being over-optimistic about expected progress when reporting to the Committee or, less charitably, of its inability to achieve set targets.

3.49 The Committee chose to pursue with the Department the question of training in investigative techniques. In response to the Committee's detailed questions about numbers of courses conducted and the numbers of officers at different levels who had completed these courses, the Department undertook a survey of the extent of training of officers in all State offices.

3.50 The Committee does not wish to comment on the result of the survey, but to make a more general observation about Customs' approach to this quite crucial part of its operations.

3.51 The Committee considers that the information obtained through this survey should have already been available to Central Office, in aggregated form, to enable Customs to plan its training program and direct training efforts to areas of greatest need. The Committee cannot understand how the Department could possibly be planning or managing resources responsibly in this area without such an overall picture of what has already been achieved and where the gaps are.

5. The Committee recommends that the numbers of officers who have undergone adequate training and the numbers still requiring training in specified skills be monitored by Central Office.

1 Minutes of Evidence, op. cit., p. 390.

Staffing Levels

3.52 Many of the general management difficulties experienced, have been attributed to inadequate staffing of the Central Office units responsible for the development and coordination of excise collection strategies and procedures. For example, in Appendix 2 of the Efficiency Audit Report, the Auditor-General stated:

'Audit found that Central Office has not undertaken systematic analyses of the general control problems associated with individual dutiable commodities and to assess industry-wide production systems and distribution networks from the point of view of opportunities for evasion. Collectorates have largely functioned independently and as a result, national intelligence or operational information has not been sufficiently collated and applied to the improvement of administration ...

The currently limited role of Central Office in Inland Services' program direction and co-ordination is ascribed by the Department to the low relative priority accorded Inland Services in Central Office. The Department advised that, in response to other priorities, a decision was taken in 1975 to reduce the Central Office Inland Services' organisation from Branch to Section level.'

3.53 At the public hearing on 7 May 1984 the Department informed the Committee that there had been considerable staff increases over recent years. At the time when the Efficiency Audit Report was tabled there were 27 Central Office staff in the Inland Services and Resource Excise areas while on 7 May 1984 there were 48. The Department also indicated that associated with these increases a new Division has been created. This is known as the Inland Revenue and Dumping Division and has two branches devoted to the excise function, the Inland Services Branch and the Resources Excise Branch. In the Inland Services Branch there are two directors, one responsible for operational matters and the other for planning and review activities. The Resources Excise Branch has three directors: one responsible for bounties and the others for operational matters in the resources excise area.

3.54 The Committee considers that co-ordination and strategic planning are vital in excise collection to ensure that consistent and efficient procedures are used all over Australia and this can only be done with a strong Central Office role.

3.55 The Committee therefore welcomes these increases in staffing at Central Office but is deeply concerned that it has taken so long to build up the staff levels in an area that is responsible for very significant amounts of tax revenue.

3.56 During its visit to Bundaberg the Committee also became aware that there are Customs Sub-Collectorates which have very low staffing levels and are responsible for millions of dollars of revenue. For example, Bundaberg has a total of four staff and responsibility for over \$10 million per year in excise collection alone. If the risk assessment approach being developed currently is applied nationally, it should ensure that there are no significantly under-resourced pockets.

3.57 The risk assessment approach should be applied by comparing risks to revenue at different locations and examining relative staffing levels. The Committee, however, is not convinced that the Department's risk assessment system has yet reached such sophistication and considers that the staffing issue needs immediate attention.

6. The Committee therefore recommends that the Department undertake, as a matter of urgency, a comprehensive review of staffing requirements in Central Office and the States. The key issue which should be considered in this review is the level of staffing required in the various Customs offices to protect adequately the revenue collected through those offices.

CHAPTER 4

DISTILLED SPIRITS

General Background

4.1 Customs and excise duties and sales taxes are levied on spirituous beverages including brandy, rum, whisky, gin, vodka and liqueurs. In 1983/84 excise revenue from spirits totalled \$118 million. This compares with \$114 million in 1982/83 and \$121 million in 1981/82. Revenue from customs duty on imported spirits amounted to approximately \$228 million in 1983/84.

4.2 Indexation of excise rates was introduced in the 1983 Budget. The rates will be increased every six months to reflect increases in the Consumer Price Index (CPI). In February 1984 the excise rate for brandy became \$17.37 per litre of alcohol, the general rate for other spirits became \$20.36 per litre of alcohol and \$20.90 per litre of alcohol for other spirits and liqueurs.

4.3 The production, bottling, storage and distribution of these items are all subject to Inland Services controls. The initial duty liability falls on the quantity of alcohol received by 'spirit receivers' (storage vessels at the end of the distillation process). Excise is paid on packaged quantities at the time of release of the goods to the market. Distillers are required to account for losses between the stage of initial duty liability and packaging.

4.4 There are approximately 30 general distillers who distill a range of different spirits, 30 wine distillers who only distill wine into brandy and over 300 wine fortifiers (i.e. most wine makers). In June 1983 there were also:

- . 85 under-bond bottlers;
- . approximately 27 out-of-bond bottlers who purchase and bottle duty-paid spirits;
- . 155 spirit storage bonds; and
- . 76 general bonds also handling packaged spirits.

4.5 Customs controls include licensing and registration of producers and dealers supported by field and documentary checks, with the latter being regarded as the primary control mechanism.

4.6 Two areas which are of particular concern to the Committee, and which perhaps bear some further background explanation here, are:

- spirit used to fortify Australian wine; and
- duty free spirit for industrial, scientific and medical applications.

Spirit Used to Fortify Australian Wine (2J Spirit)

4.7 Prior to 23 August 1983, spirit for fortifying Australian wine (excise item 2J) was free of duty provided it was actually used for this purpose.

4.8 Fortifying spirit became dutiable at \$2.61 per litre of alcohol as from 23 August 1983. On 21 September 1983, however, this was reduced to \$1.50 per litre of alcohol, backdated to 23 August. In February 1984, as a result of six-monthly indexation, the rate became \$1.56 per litre of alcohol. This duty was removed on 22 June 1984 and it was subsequently announced that revenue so raised would be refunded.

4.9 Under the system which operated for some 10 months the spirit was liable to duty as soon as it was used for fortification purposes and the duty was payable under the normal weekly settlement arrangements for paying excise duties. If the spirit were used other than to fortify wine, duty was payable at up to \$20.08 per litre of alcohol. Customs controls were maintained up until the spirit was used for the express purpose of fortification of Australian wine.

4.10 It should be noted that the disparity in treatment of fortifying spirit compared with other potable spirits creates an incentive for the illegal diversion of fortifying spirit to other spirits. The Committee makes further comment on this issue at the end of this chapter.

Duty Free Spirit for Industrial, Scientific and Medical Applications

4.11 Alcohol used for a range of non-potable purposes is excise free but is subject to supervision by Customs because of the potential for substitution for potable spirit. Spirit used for non-potable purposes accounts for more than 80% of total spirits production in Australia.

4.12 Denatured spirit used in non-potable applications is excise free. Denaturing is carried out by the addition of toxic substances to make the spirit unfit for consumption. Denaturants are specially selected to be unfit for consumption, difficult to separate from alcohol and compatible with the intended downstream industrial use of the alcohol.

4.13 Alcohol for non-potable use is produced in three forms:

- fully denatured alcohol - completely outside Customs control (approximately 26% of production);
- 'specially methylated' or 'partly denatured' alcohol - users must have Customs approval to purchase (approximately 60% of production); and
- pure or undenatured alcohol - users must have Customs approval to purchase (approximately 15% of production).

4.14 When such alcohol is used for industrial, scientific, educational or therapeutic purposes it is excise free. These spirits are listed in the excise tariff schedule under the following items:

- 2M - spirit for industrial or scientific purposes (for use in manufacture of vinegar, essences, scents and toilet preparations);
- 2N - specially methylated (or denatured) spirits;
- 2P - spirit for scientific or educational purposes;
- 2Q - spirit used for medical purposes (e.g. in public hospitals, universities etc. and for medicinal preparations).

4.15 Spirit covered by items 2M, 2P and 2Q is pure alcohol and chemically indistinguishable from alcohol used in alcoholic beverages. This raises the possibility of diversion of duty-free spirit to potable uses to avoid duty. (The Committee comments on this in a later section of this Chapter.) On the other hand item 2N covers spirit used for industrial purposes and specially methylated to make it non-potable by the addition of toxic chemicals.

4.16 CSR has the major share (approximately 90%) of the market for spirits covered by items 2M, 2N, 2P, 2Q. Bundaberg Sugar Company is the other producer of non-potable spirit.

The Auditor-General's Comments

4.17 The Auditor-General identified several areas of risk to revenue. The major areas are summarised below.

Verification of production

The Auditor-General claimed that since Inland Services is unable to verify company production independently, revenue erosion through the understatement of the initial excise liability is possible. Physical and

clerical checks are performed on an occasional basis by Inland Services but do not provide comprehensive confirmation of production. For spirits, the production process involves distillers and bottlers;

Distillers

Independent monitoring of distilling production volumes could be achieved through sealed meters. Audit considered that the potential application of sealed meters to stills to measure production should be pursued by the Department. (Audit also pointed out that in the UK the point of liability is set earlier in the production process.);

Bottlers

The Auditor-General stated that the major risk to revenue associated with licensed bottlers is the possible understatement of production and release of the excess without duty payment. Other risks lie in false scheduling of duty-free exemptions, tariff misclassification and late payment of duty. Understatement of production could occur through bottling of more than the recorded stocks of bulk spirit and through overstatement of losses, underfilling of bottles or understrengthening of contents;

Out of bond (unlicensed) bottlers

Duty could be evaded by extension of duty-paid stocks with duty-free bulk spirit;

Losses

The Auditor-General stated that Inland Services' controls over production losses of spirit were deficient in that losses were accepted on the basis of historical performance of individual licensees, without independent technical analysis. Losses on customable and excisable clearances can amount to as much as \$12 million per annum (3% of customable and excisable clearances). Audit considered that the data base available did not permit Inland Services to monitor spirit losses effectively and that national loss standards should be developed as a guide to control officers.

Control over product substitution

Audit stated that the production of substitutes is a major revenue risk for spirits. This has two aspects: the production of potable products not subject to duty as substitutes for dutiable items; and the addition to, or substitution of, duty-free spirit for spirit subject to duty in the production of dutiable items;

- Control over use of 2M 2P and 2Q spirit
Audit drew attention to Inland Services' own surveys which suggest that users of duty-free spirit under these tariff items do not keep adequate records of uptake and use of spirit;
- Controls over spirit used for fortifying wine (2J spirit)
The Auditor-General expressed concern about this area because of the considerable incentive and scope for substituting 2J spirit for potable spirit subject to duty. The incentive arises from the considerable difference in value between the two products. In Audit's words:

'not only are there more producers, but there is greater scope for producers to divert product as grape stocks are used for many purposes, most products not being under Inland Services' control and stocks cannot be reconciled with 2J production. For example, grape stocks may be used for wine production or for distillation as brandy or high strength spirit and only some of the latter may subsequently be cleared as 2J spirit. 2J spirit is chemically closely similar to brandy, and is a ready base for liqueurs.'; and

- Additional control tools suggested by Audit
Because of the complexity of the spirits industry Audit suggested that the Department should consider alternative ways of collecting the excise revenue on spirits, such as by means of a sales tax. Audit also suggested that the Department examine the possibility of using high resolution chemical analysis in their investigation procedures. This method could be used to distinguish alcohols produced from different raw materials.

4.18 The 'Concluding Summary' of the Auditor-General's Efficiency Audit Report contained the following recommendations:¹

- (i) A risk management approach based on concentrating control efforts on areas of greatest risks of loss of duty should be applied. The approach should include using workload, efficiency and effectiveness data as the basis for resource deployment and details are set out in Appendixes 1 and 2 (of the Audit Report).
- (ii) A consolidated data base on losses should be prepared as a basis for decision on a standard losses policy. There should be a move away from acceptance of losses on the basis of patterns of precedent to one based on objective assessment of the production processes.

¹ The Efficiency Audit Report, op. cit., p. 12.

- (iii) In view of the difficulties associated with control over excise revenue the relative advantages of an extension of sales tax vis a vis the current excise duty should be considered for review by the appropriate authorities.
- (iv) Changes in production and consumption patterns for alcoholic beverages (e.g., away from dutiable items) and the consequent possible need for amendment of the Excise Tariff, should be monitored.'

Appendix 4 of that report also contained a further recommendation on spirits.¹

'Audit recommends that the Department investigate the feasibility and cost of chemical analysis as a control tool.'

Departmental Response

4.19 The Department accepted the Auditor-General's recommendation that risk management principles should be applied to ensure that control efforts in the spirits area are concentrated on areas of greatest risk.² The Department is developing a risk management system for use across all commodities. The issue is discussed in Chapter 3 of this report.

4.20 In its first submission to the Committee the Department stated that³

'A Working Party comprised of officers from the States and Central Office is examining losses with a view to achieving a national loss control policy.'

4.21 In a later submission to the Committee the Auditor-General's recommendation on a standard losses policy was specifically accepted by the Department and reference was made to the Working Party.⁴

4.22 After several written requests to the Department seeking clarification about progress in the losses area it became apparent that the Working Party had been disbanded after reporting to the September 1982 Collectors' Conference. The Conference had accepted the Working Party's recommendation that all spirits volume measurements be corrected to the standard temperature of 20° celsius.

1 The Efficiency Audit Report, op. cit., p. 55.

2 Minutes of Evidence, op. cit., p. 317.

3 ibid., p. 27.

4 ibid., p. 317.

4.23 Other findings reported by the Working Party included:

- ' there are insurmountable difficulties in fixing a standard loss tolerance for vat storage;
- . States apply a scale of loss allowance to cask storage but the scale varies from State to State;
- . there are no common bottling loss allowances;
- . there is no common approach to the seeking of loss data or returns from companies, the frequency of lodgement, format or content of the returns.'

4.24 The same Working Party also made the suggestion that consideration should be given to a simplified approach to loss control, involving an adjustment for losses being given in the applicable rate of duty.

4.25 In a written response to the Committee, dated 12 December 1983 the Department stated that 'the goal of establishing industry standards may not be practicable given the differing products manufactured, processes, equipment and efficiencies which exist in the spirits industry'. The matter of loss control for all commodities was not clarified at the public hearing on 7 May 1984¹ when the Department stated:

'The area that we have concentrated on so far has been the spirits area, and our spirits review is still examining that particular aspect.'

and

'...in terms of the national loss control policy, the only area we are making significant progress in at the present time is the potable spirits area.'

4.26 On the issue of collecting revenue as sales tax rather than excise, the Department initially stated that it would be discussing the matter with the Australian Taxation Office.² On 12 August 1983, however, the Department submitted that:³

'Action dependent on Government direction as this Recommendation involves Government taxation policy.'

4.27 The issue of sales tax versus excise is dealt with in some detail in the next section of this chapter.

1 Minutes of Evidence, op. cit., p. 527.

2 ibid., p. 8.

3 ibid., p. 317.

4.28 The Department rejected the recommendation that Customs should monitor changes in production and consumption patterns for alcoholic beverages.¹ The grounds given were that this related to a government taxation policy matter which was not seen as a Customs responsibility and that resources were too limited.

4.29 The recommendation that the Department should investigate the feasibility of chemical analysis as a control tool was accepted by the Department. This matter is to be taken up in the recently announced review of the spirits industry (see below).

4.30 At the public hearing on 7 May 1984 the Department informed the Committee that a review of their spirits operations had been initiated.² The review, which is to examine the effectiveness of controls, will concentrate initially on concessional spirits and then potable spirits.

Industry Views

4.31 As a part of the inquiry the Committee inspected distilleries and bottling plants in Sydney, the Barossa Valley and Bundaberg. These visits gave the Committee an opportunity to become familiar with the technical processes involved in distilling and bottling, to examine the control systems employed and to seek the views of the industry on the matters raised by the Auditor-General.

4.32 During the course of the inquiry the Committee had many opportunities to seek informal views from various parts of the spirits industry. In this process the Committee became aware of considerable concern in the industry about unfair competition from operators who appear to be avoiding at least part of their duty liability. (See comments at the end of this chapter.)

4.33 The Committee also received submissions from several groups concerned with the distilled spirits industry, and more particularly, with Audit's response to the problems it perceived in the area. Among the contributors were:

- Distilled Spirits Industry Council of Australia and the Federated Wholesale Spirit Merchants Association of Australia in a joint submission;
- Australian Wine and Brandy Producers' Association Inc;
- Tarac Industries Pty Ltd; and
- Bundaberg Sugar Company Ltd.

1 Minutes of Evidence, op. cit., p. 317

2 ibid., p. 522.

4.34 In addition to general comments on the approach taken by Audit, these submissions also addressed specific issues highlighted in the Efficiency Audit Report. Industry's general reactions and these specific issues are dealt with below.

General Reactions

4.35 A common general reaction by industry groups to the Efficiency Audit Report, was to offer assurances of the integrity of members and state that the Report indicated a lack of appreciation of the practicalities of the distilling industry.

4.36 Tarac Industries Pty Ltd, for example, disputed the assertion that there are incentives and many avenues for revenue evasion. They claimed that 'commodity control has operated smoothly for more than a decade with little proven malpractice or even suggestion of it.' The submission by the Distilled Spirits Industry Council of Australia and the Federated Wholesale Spirit Merchants on the other hand, referred to a single case where Inland Services detected that duty on fraudulently unrecorded product amounted to \$0.5 million.

Point of Liability for Excise Duty

4.37 The Auditor-General noted that in the UK liability for duty is determined earlier in the production process than in Australia. In the UK duty is determined on wort and wash production. This approach was not supported in the industry submissions received by the Committee. The Distilled Spirits Industry Council suggested that excise on spirits should be seen as a consumption tax and not a production tax and shifting the point of liability forward to the wort and wash stage is impractical. It claimed that in distilleries producing both industrial and potable spirits (i.e. some spirits free of duty and others dutiable) there were too many side streams and recycling stages for adequate control.

4.38 While the Wine and Brandy Producers' Association shared the Council's view that liability for excise should be placed at the last point prior to release for home consumption, Bundaberg Sugar Company pointed briefly to the ramifications of shifting the point of liability, either to a point earlier in the production process or later in the production process. Bundaberg submitted that shifting the point of liability back in the process would lead to measurement problems especially where there was variability of product yield. On the other hand Bundaberg contended that shifting the point of liability forward may create problems in apportioning loss volumes among joint products (such as rum, industrial alcohol and denatured spirit) when only some of these may be subject to duty.

Verification of Production

4.39 The Efficiency Audit Report drew attention to Inland Services' inability to verify the production data declared by companies. Audit suggested that independent monitoring of distillery production volumes by sealed meters should be considered as a method of overcoming this deficiency.

4.40 Industry submissions advanced numerous problems which would hinder the accurate measurement of spirit production with meters, including differing spirit strengths and variations in temperatures along pipelines. Industry did not believe that the technology was capable of meeting the complexities and vagaries of the process. In addition, concern was expressed regarding the cost of the devices - particularly if they were to be used in addition to current controlling mechanisms and if back up control devices were also installed. Bundaberg Sugar Company estimated that the instruments required would cost \$30,000 before installation. It also doubted whether at this price the meters could be made adequately secure.

4.41 To counter Audit's argument that additional controls, such as independent monitoring of production by sealed meters, were necessary, the Distilled Spirits Industry Council and the Federated Wholesale Spirit Merchants' Association contended that:

- Inland Services has access to distilleries and can compare actual raw material yield and expected yield and this process should quickly identify any diversion;
- the collusion required to thwart current controls would have to be extensive and large enterprises are not motivated to engage in such activity; and
- verification of bottle levels and contents are already handled by weights and measures authorities and health authorities.

4.42 Audit noted that out-of-bond bottlers may evade duty by extension of duty-paid stocks with duty-free bulk spirit. This point was picked up in several submissions. It was suggested that to safeguard against such fraudulent behaviour spirits bottling should only be permitted on licensed premises under the control of the Department of Industry and Commerce and particular attention should be paid to out-of-bond bottlers in isolated areas. Bundaberg Sugar Company not only supported the proposition regarding out-of-bond bottling but also suggested that all production steps should be brought under Customs control and the potential for using ADP analysis of movements as a control device should be realised.

4.43 The Wine and Brandy Producers' Association also advocated that all bottling be done under bond. The Association suggested an encouragement for this by removal of the separate licence charges for bonded warehouses. This would permit, for example, an Australian distiller to bottle imported, under-bond spirits as well as his/her own product without having to pay for another licence.

4.44 Bundaberg Sugar Company made the general point that improvements in controls would increase costs. It speculated that penalties were too low to encourage improved control among less conscientious firms, and advocated that liability for losses and penalties for avoidance/evasion of duty should cover Inland Services' costs, in large measure.

Losses

4.45 Audit drew attention to the dearth of quantitative information on losses and stated that 'Inland Services was aware of the major factors affecting losses but had only limited data on the quantitative impact of some of these factors.' The Distilled Spirits Industry Council and the Federated Wholesale Spirit Merchants' Association of Australia downplayed this issue. They submitted that losses had received 'an inordinate expenditure of bureaucratic manhours disproportionate to the magnitude of the perceived problem'.

4.46 A common sentiment amongst distilling industry groups was that losses in distilling and bottling were inevitable and in fact were an intrinsic part of the production process as were variations in efficiencies. Tarac Industries Pty Ltd, for example, objected to Audit's quest for a system of loss control based on some objective assessment of the process. It claims that for its own purposes it had a refined approach to inventory control (losses and gains) as part of the distilling process. In essence, normal business practice operating from the impetus of the profit motive was a potent deterrent against excessive losses - indeed a more potent deterrent than regulatory measures.

4.47 Of significant concern to the industry were the number of variables which could influence production, bottling and measurement. Tarac Industries Pty Ltd, for example, submitted several pages of material on factors contributing to losses in the distillation process. Mention is made of some of these contributing factors, in the paragraphs following.

4.48 Variations and losses may arise while feedstock wine is being handled. These may be due, for example, to the limited accuracy of sampling from large wine charges where there may be a mixture of thick and thin wine and water. There are also difficulties in accurately dipping gassy and frothy material, and in determining alcohol content. The measured alcohol strengths may vary according to the method of determination used eg hydrometry, refractometry or chromatography.

4.49 At distillation there can be losses from the still vent when pressure build-up in the still is released, from leaks in flanges, manholes or corroded pipes or resulting from vaporisation if products are not sufficiently cooled. During spirit movement and storage, there may be leakages, shrinkage of product volume on cooling, evaporation of spirit while dipping tanks and variations resulting from different calibrations of vessels.

4.50 Transportation and spirit maturation are also stages during which variations in measurements and losses may occur. Factors which impinge on readings during the transport phase include the accuracy of road tanker calibrations, the sealing effectiveness of valves and manifolds and temperature fluctuations in transit. Figures provided by Tarac relating to losses during spirit maturation suggest that losses vary over a two year period from 5.5% to 3.7% according to whether small wood or large wood vessels are used and the age of those vessels. Revatting, according to Tarac, accounts for losses of 0.8%.

4.51 While quite extensive material on the factors which may contribute to losses and variations along the production process was provided, there was only very limited information provided as to their magnitude. This observation is consistent with the Auditor-General's findings regarding the lack of quantitative information on losses.

4.52 The industry groups submitted that there were significant difficulties involved in developing an industry benchmark for losses. The Distilled Spirits Industry Council asked, for example, how should the standard be set without being too low (and thus allowing an unprecedented bonus for the majority of the industry) or being too high (and thus imposing costs on the majority of the industry who may be forced to install costly equipment to match the high standard). For their part, Bundaberg Sugar Company advised that losses should be considered specifically for individual segments of the industry and for various stages within each segment. It suggested that not only do losses vary between different types of product, for example rum versus brandy, but also losses vary between regions for a given product. One factor contributing to this variation between regions is climate.

4.53 The treatment of losses is one of the issues taken up by the Committee at the end of this chapter.

Substitutes

4.54 While there was general agreement on the potential for substitution between dutiable and non-dutiable product, there was considerable diversity of opinion on the manner by which best to minimise the problem. The joint submission from the Distilled Spirits Industry Council of Australia and the Federated Wholesale Spirit Merchants' Association supported an equivalent tax on 2J spirit (that is the grape spirit used for wine fortification purposes) as on other spirits. This move would reduce the

incentive to substitute or extend dutiable material with 2J spirit. These groups did not support a concessional rate of duty for fortifying spirits.

4.55 In contrast, the Wine and Brandy Producers' Association sought an abolition of the \$1.56 per litre of alcohol tax on 2J spirit. It argued that this impost would not overcome the diversion and substitution problems and only make 2J spirit a less viable product. This view was also put by Tarac and Penfolds during the Committee's visit to distilleries in the Barossa Valley. Informal information provided to the Committee suggested that some operators had been particularly ill-affected by the tax and that grape stocks would accumulate as its use in spirit fortification declined as a result of the increased cost of fortifying spirit. (The excise on grape spirit for fortifying wine was abolished on 22 June 1984.)

4.56 The joint submission from the Distilled Spirits Industry Council and the Spirit Merchants' Association also suggested that to counter substitution, greater use be made of Section 7 of the Excise Tariff Act in relation to substitutes and imitations of excisable goods. (Section 7 empowers the Minister to direct that goods which could be substituted for any excisable goods, or are intended to be, will be charged at an appropriate excise rate.) They also recommended that more stringent controls be introduced in relation to 2M, 2N, 2P, 2Q spirit which are the undenatured and specially methylated types of spirit. Bundaberg Sugar Company also suggested a tightening of controls particularly by ADP analysis of stock and transfers.

Alternative Methods

4.57 A number of submissions from spirits industry groups canvassed the additional control tools suggested on page 55 of the Efficiency Audit Report. The Distilled Spirits Industry Council and the Federated Wholesale Spirit Merchants' Association supported consideration of the use of chemical analysis to detect product substitution. They indicated that they would like to be able to explore this with the Department of Industry and Commerce.

4.58 The Bundaberg Sugar Company's view of the usefulness of chemical analysis was much less sanguine. In its opinion, chemical analysis was severely limited in its possible use for the detection of substitution or extension. The Company instanced that extension of brandy, illegally, using 2J spirit, would be very difficult to detect by current chemical analysis procedures as the chemical ratios of the two products were very similar. The Company suggested, however, that chemical analysis be undertaken as an occasional, supplementary exercise rather than as standard procedure.

4.59 The Bundaberg Sugar Company supported the development of a consolidated data base and extended ADP facilities to improve revenue security. It noted that the network should cover all production processes rather than concentrate only on one aspect such as warehousing. Bundaberg suggested that additional data, may not be necessary as it may be sufficient to improve the quality of data already supplied - perhaps by using material from other bodies such as the State Licensing Board and the Australian Bureau of Statistics.

Extension of credit period

4.60 While making their views known on issues raised by the Efficiency Audit Report, several groups took the opportunity to press for an extension of the credit period for payment of duty. It was argued, that this would be appropriate given the significant financial burden of the tax and the favourable terms which had been extended for excise payment on crude oil and coal exports. Bundaberg Sugar Company advocated an extension of the current credit period for payment of duty. At present, it was argued, the credit extended averages 3.5 days. The Company sought an extension of at least one week.

Sales Tax versus Excise

4.61 In summarising the findings of the Efficiency Audit the Auditor-General noted that, in relation to duties on spirits:

'...given the difficulties of the control task and the fact that spirits are also subject to a sales tax, Audit suggests that, as part of a more systematic examination of current control procedures, the Department, in consultation with the Taxation Office, investigate the possibilities for collecting by way of sales tax, revenue now payable as excise duty. The attraction of this option would be that it would no longer be necessary to apply controls to producers; the existing control system applied to sales tax collection at the wholesale level would be used.'

4.62 The Committee pursued this suggestion, taking it to be a general proposition for extension of sales tax to currently excisable products, and it obtained advice from the Department of Industry and Commerce, the Commissioner of Taxation and the Commonwealth Department of the Treasury. The Treasury and Taxation submissions are reproduced at Appendix 2. The suggestion also received comment from elements of the distilled spirits and tobacco industries in their submissions.

1 The Efficiency Audit Report, op. cit., p. 6.

General Information on the Tax System

4.63 Before undertaking a review of the points raised in the various government and industry submissions, it may be useful to consider some background information on the section of the tax system on which the Auditor-General's suggestion impinged.

4.64 Excise duty is a tax on goods and services and is paid indirectly via the purchase of those items. Accordingly, excise is an 'indirect' or 'commodity' tax. Broadly, goods of a type which are subject to excise when manufactured in Australia are automatically subject to a similar customs duty when imported. In addition to this 'excise component' of customs duty, there is a 'protective component' which is designed to provide assistance to domestic industry.

4.65 Excise on commodities such as alcohol and tobacco has its rationale partly as sumptuary taxation. A sumptuary tax is one that is levied on the manufacture, sale or consumption of a good or service deemed to be 'undesirable'. The purpose of the tax is to reduce consumption of the good or service relative to other goods or services. While excise on spirits, beer, tobacco and petroleum products produces significant revenue, this 'moral' aspect distinguishes it somewhat from sales tax which broadly functions as a general revenue raiser. Associated with the notion of sumptuary taxation is the notion of externality. It is generally accepted that the consumption of alcohol or tobacco imposes costs and benefits which are not born only by the consumer. Society at large, for example, bears some of the costs associated with the health care required in the treatment of alcoholism and other drug abuse. The excise system partially takes such considerations into account.

4.66 Excise in Australia is a 'unit tax'. This means that it is applied at a specific rate per unit of quantity. For example, excise on brandy is levied at the rate of \$17.37 per litre of alcohol irrespective of whether it is a cheap or an expensive brandy. Because the tax is levied per physical unit, tax revenue increases only when consumption of the particular item subject to tax increases or when the rate of tax is increased. In other words, an increase in price under a unit tax system reduces the real value of the tax rate unless the nominal rate is increased to keep pace. The 1983 Budget decision to introduce half-yearly indexation of the excise rates largely overcomes this erosion.

4.67 Like excise, sales tax is a tax on goods and services. However, unlike excise, sales tax is levied on an ad valorem basis. This means that the tax is expressed as a proportion of value. Consequently tax revenue increases with price increases as well as with increases in consumption. The real value of an ad valorem type of tax is maintained when prices increase. This adjustment is automatic and does not rely on discretionary adjustments in the tax rate.

4.68 The Commissioner of Taxation provided the Committee with very useful background material on the operation of the sales tax system. The remainder of this sub-section draws heavily on that material.

4.69 Sales tax is a single stage tax which is designed to fall primarily on sales by wholesalers and manufacturers, to retailers. The intention is that all goods which are produced or imported into Australia for use or consumption in Australia bear sales tax unless they are subject to a specific exemption. The levy, in fact, is not limited to sales only. Imported goods are taxed when imported by retailers and consumers and goods leased by tax payers are also subject to sales tax.

4.70 Sales tax is payable by three general classes of persons: manufacturers, wholesalers and importers. Manufacturers and wholesalers who are dealing with taxable goods must register with the Tax Office in each State in which they have a place of business. The Commissioner issues the registering parties with a certificate which enables the manufacturing wholesaler to purchase his raw materials or inventory, free of tax.

4.71 Tax is incurred only at the point of the last wholesale sale to the retailer. A manufacturer who sells to a wholesaler would be given a 'quotation of certificate' by the purchaser and would not be required to pay tax. The wholesaler who sells to a retailer charges his/her customer tax and accounts for that tax on monthly returns lodged with the Tax Office. Payment of the tax accompanies the return.

4.72 Manufacturers and wholesalers who purchase imported materials or goods may do so free of sales tax by quoting their certificate number when clearing the goods for home consumption. Wholesalers charge sales tax when they sell to retailers. In the context of the spirits industry, under the sales tax law, the category 'manufacturer' includes parties who import, blend or dilute overproof spirits to derive a product suitable for consumption. Thus an importer of overproof spirits to be diluted, blended and bottled in Australia enters the goods at Customs, free of sales tax by quoting his/her certificate number. Import duty is payable when the goods are cleared from bond, ie. entered for home consumption. Sales tax is levied at the point of the last wholesale sale in Australia.

4.73 Sales tax is payable on what is termed 'sale value'. In general terms, this means the amount for which the goods are sold. Where, for instance, the taxable transaction is something other than a sale by a wholesaler to a retailer, tax applies to an amount which represents a fair wholesale value of the goods.

4.74 Sales tax is generally payable to the Taxation Office 21 days after the month in which the last wholesale sale was transacted. In contrast, excise and customs (import) duties are payable when the goods are entered for home consumption at which time they are removed from Customs control. Generally, there is a settlement period of 7 days.

4.75 There are four rates of sales tax - 7.5%, 10%, 20%, and 32.5%. Some goods are exempt from sales tax. Of the excisable commodities, potable spirits, liqueurs and spirituous liquors whether imported or locally produced, imported beer and imported non-alcoholic grape wine and cider are taxable at 20%. Beer of not more than 1.15% alcohol by volume is free of excise duty but is subject to 20% sales tax. Domestically produced beer with an alcoholic strength of more than this amount is excisable but is exempt from sales tax. Imported beer is subject to 20% sales tax irrespective of its alcoholic content. Non-alcoholic mead, perry, sake, other similar fermented beverages and beverages similar to cider or wine are exempt from sales tax whether they are imported or locally produced.

4.76 As from 21 August 1984, sales tax at the rate of 10% is applied to Australian and imported alcoholic wine, cider, mead, perry, sake and other similar fermented alcoholic beverages. Imported alcoholic grape wine will also be subject to additional ad valorem customs duties, equivalent to a discriminatory tax of 10%, while imported alcoholic ciders are subject to additional ad valorem customs duties equivalent to a discriminatory tax of 20%. Similarly, imported non-alcoholic beer is subject to additional ad valorem customs duties equivalent to a discriminatory tax of 20%. Those products are not subject to excise duties. Tobacco and tobacco products and petroleum products such as crude oil, petrol, kerosene and diesel fuel which are excisable are exempt from sales tax whether produced in Australia or produced overseas.

4.77 For the purposes of the sales tax legislation, beverages are regarded as being "non-alcoholic" where they do not contain more than 1.15% by volume of alcohol.

The Sales Tax Proposal - Implications

4.78 As mentioned earlier, a feature of an ad valorem tax such as sales tax is that the rates automatically maintain their real value in the face of rising prices whereas per unit tax rates decline in real value unless they are specifically adjusted in line with prices. Data produced by the Department of the Treasury in August 1983 document the fluctuations (and overall decline) in the real rates of excise in the period 1973/74 to 1983/84. Those figures are reproduced in Table 4.1.

4.79 The 1983/84 Budget introduced six-monthly indexation of excise rates based on movements in the Consumer Price Index (CPI), with the adjustments to be made in August and February each year. (The protective element of customs duties is not adjusted as part of this process.)

4.80 Elements of the spirits industry argued that the 1983 Budget initiatives to index excise duties and the excise component of customs duties and the decision to levy excise of \$1.56 per litre of alcohol on grape spirit used in fortifying wine, (item 2J in the Excise Act), remove the justification for the sales tax option. (It should be noted that the excise on grape spirit was removed on 22 June 1984 and revenue so collected is to be refunded in 1984/85.) The Bundaberg Sugar Company, for instance, changed their position on the sales tax/excise topic as a result of the 1983 Budget measures. Its May 1982 submission claimed that incentives for substitution would be reduced if the sales tax proposal were taken up. Its September 1983 submission argued, however, that the newly introduced excise on grape spirit, albeit at a concessional rate compared to other spirits, reduced the incentive for the illegal use of 2J spirit in the extension of duty-paid spirit. The Company also maintained that as with the sales tax case, the six-monthly indexation of excise rates would enable excise rates to keep pace with inflation and also remove the need for pre-Budget quota controls to curtail speculative buying.

4.81 While the excise indexation measures eliminate one reason for the extension of sales tax, there is another feature of the excise system which bears consideration. A per unit tax such as excise imposes an equal absolute burden on products subject to duty. However that burden is more significant for cheaper items than more expensive items. In contrast, an ad valorem type of tax imposes a burden which is constant compared to the value of the product, although it may vary in absolute terms between similar types of product. An ad valorem tax therefore does not influence price relativities between more and less expensive products. In this sense an ad valorem tax does not give distorted signals to consumers and producers regarding the relative attractiveness of items and is to be preferred on resource allocation grounds.

TABLE 4.1 REAL AND NOMINAL RATES OF EXCISE DUTY

	Beer (\$/litre)		Portable Spirits (\$/lt. all(a))		Cigarettes \$/kg. tobacco		Motor Spirit (cents/litre)	
	nominal	real (b)	nominal	real (b)	nominal	real (b)	nominal	real (b)
1973-74	0.253	0.253	6.80	6.80	14.00	14.00	4.905	4.905
1974-75	0.253	0.208	9.35	7.68	16.10	13.22	4.905	4.027
1975-76	0.394	0.277	10.21	7.19	19.36	13.63	4.905	3.454
1976-77	0.394	0.249	10.21	6.46	19.36	12.25	4.905	3.104
1977-78	0.394	0.230	10.21	5.97	19.36	11.32	5.155	3.015
1978-79	0.520	0.285	18.75	10.28	24.75	13.57	5.155	2.826
1979-80	0.520	0.260	18.75	9.38	24.75	12.38	5.155	2.578
1980-81	0.520	0.236	18.75	8.51	24.75	11.23	5.155	2.339
1981-82	0.520	0.211	18.75	7.61	24.75	10.04	5.155	2.092
1982-83	0.600	0.218	18.75	6.83	29.70	10.82	6.155(c)	2.241
1983-84(d)	0.630	0.212	19.56	6.59	30.98	10.45	9.027	3.043

(a) Rate for whisky used as an illustration.

(b) Deflated by the non-farm product deflator, 1973-74=100.

(c) The rate increased to 7.155 cpl from 1 July 1983 representing the second part of a two cent per litre surcharge, the proceeds of which, net of rebates, are allocated to a trust fund to finance the Australian Bicentennial Road Development Program.

(d) Rates applying from 23 August 1983.

Source: 1983-84 Budget Paper No. 1

4.82 The economic arguments favouring an ad valorem tax on resource allocation grounds only go some way towards resolving the question of the appropriate tax system for currently excisable goods. This is because the ad valorem prescription only applies in the case where there are no externalities associated with the good or service. Economic theory suggests that where there are no costs over and above those which flow to the specific consumer or producer (that is, negative externalities), all goods and services should be taxed at the same ad valorem rate. Where, however, there are negative externalities involved there is an argument for an additional tax on those goods commensurate with those negative externalities. In this way the producers and consumers are required to pay a cost which reflects the full costs associated with the good's or service's production or consumption. It might be reasonable to suggest that the tax consist of a per unit of value element plus, where applicable, a further component per unit of alcohol, tobacco or fuel. For spirits, the current system of sales tax plus excise duties incorporates these two elements. (This is currently not the case for excisable products such as domestically produced beer with an alcoholic strength in excess of 1.15% alcohol by volume, cigarettes and other tobacco goods, crude oil, petrol, kerosene or diesel fuel.)

4.83 Administrative implications of the sales tax proposal also need to be considered. The replacement of excise with sales tax would require that a number of excisable goods presently exempt from sales tax be made taxable. This would require a restructuring of the sales tax system to accommodate the revenue to be collected from the products concerned.

4.84 Sales tax rates would also need to be restructured. Rates required to generate equivalent revenue from spirits, for example, would be in excess of 200% - a massive increase on existing rates. The Commissioner of Taxation noted that while it would be possible administratively to alter the law to introduce such rates of sales tax, wider issues would need to be considered. Several submissions - both from the spirits and the tobacco areas - argued that there may be political problems associated with the high ad valorem rates required to generate equivalent revenue. The Distilled Spirits Industry Council of Australia and the Federated Wholesale Spirit Merchants Association made the additional point that those high rates may cause problems from the producer's point of view in that consumers may switch to consumption of less alcoholic beverages once they realise how heavily taxed spirits are.

4.85 The Efficiency Audit Report made it clear that the extension of sales tax at the wholesale level was proposed because of concern that the Department of Industry and Commerce could not exercise sufficient control under the present system without a disproportionate commitment of control resources.¹ The Taxation Office acknowledged that the Office could take on the administration of the proposed sales tax. The controls

¹ The Efficiency Audit Report, op. cit., p. 50.

exercised through regular audits by Taxation officers would replace those currently operated by the Department of Industry and Commerce. The Taxation Office suggested that since wholesalers would replace producers as the group required to account for tax and because of the significant amounts of revenue involved, there would be more frequent audits by Tax officers. (At present investigations are conducted every 3 to 8 years.)

4.86 The Committee appreciates that it may be possible to improve control and achieve administrative savings by replacing Inland Services' administration of the excise system with an extension of the sales tax system. It notes, however, that the latter system is not perfect and that there have been problems with sales tax evasion over the years. In part these problems have stemmed from wholesalers misclassifying goods to take advantage of the wide range of sales tax exemptions permitted, and also from practical difficulties in determining wholesale value particularly where the retail enterprise does not operate at arm's length from those at the wholesale level.

4.87 The Taxation Office noted that customs duties on imported goods include an excise component. Any move from an excise system to a sales tax system which ignores the excise element of customs would result in divergent treatment of imported and local product.

4.88 It is important to appreciate the practicalities or any change in the current system of commodity taxation. From the Commonwealth point of view the switch from excise to sales tax would, under present credit arrangements, involve a once-off loss to revenue. This would arise because sales tax credit terms for traditional excises average approximately 3.5 days. It is estimated that the transition would amount to a loss of excise revenue (including the excise component of customs duties) of the order of \$25 million on the basis of 1982/83 figures.

4.89 From the industry's point of view there would be disruption to the current structure of the industries concerned particularly during the period of transition from one system to the other. As noted above, the current excise system favours relatively expensive products at the expense of cheaper products. Production and marketing strategies have been formulated on the basis of this tax structure. This point was made in the submission by W.D. and H.O. Wills which held that 'much of our manufacturing and marketing methods and skills and millions of dollars of investment are determined by the current excise system'.

4.90 A change in the tax system would influence production strategies and may also lead to changes in market shares. There would be winners and losers in this transition and among the winners would be consumers, producers and importers of cheaper products. The Bundaberg Sugar Company Limited extended this argument and claimed that in fact there would be a tendency

to produce inferior products and there would be increased activity by backyard operators which would increase the surveillance burden on Inland Services.

4.91 Another practical consideration is that collection of all the revenue as sales tax would increase the time that excisable products need to be under Government control. This would mean that there would either be increased risk of diversion or a greater requirement for resources to control the product or both. It must also be remembered that the product, in the case of spirits, would be potentially very valuable during this period prior to the collection of the sales tax. This period would extend from the time of production until the point of the last wholesale sale. The incentive and opportunity for diversion would appear quite considerable.

4.92 The Auditor-General¹ summarised the control problems in the spirits area in the following terms:

'There is no question that a large and intricate control network is required to manage the risk for spirits given the incentives and many avenues for revenue evasion.'

In view of the considerable control difficulties experienced under the present arrangements for collection of excise on spirits the Committee cannot support the proposal to collect excise revenue as sales tax. In the Committee's view this move would only increase the opportunities for evasion of the tax and would therefore exacerbate control problems.

4.93 Another consideration is that under the present arrangements the risk to revenue is in a sense diversified for some products because the money is collected in two stages: as excise and as sales tax. Collecting all the revenue in one stage would in a sense consolidate this risk into one collection point. Successful evasion of this one new tax would deprive the Commonwealth of all revenue from spirits whereas under current arrangements both stages have to be avoided to achieve this end.

The Committee's Comments and Recommendations

4.94 As indicated earlier in this chapter, parts of the spirits industry seemed convinced that significant evasion of duties on potable spirits does occur, either by extension of duty-paid spirit with duty-free or fortifying spirit or by sale of spirit on which duty has not been paid. The Committee is most concerned about the possible effects of such practices because of the great difference between the cost of duty-paid spirit compared with duty unpaid spirit. The incentive to avoid duty is clearly considerable.

1 The Efficiency Audit Report, op. cit., p. 54.

4.95 The potential disruptive effect on the market, of duty-unpaid spirit competing with duty-paid spirit, is also considerable. The Committee is particularly concerned about the potential effect on the viability of honest operators, of the marketing of spirit which may be costing the dishonest operator up to \$7 or \$8 per bottle less than the cost incurred by the honest operator. The problem has serious implications not only for the Commonwealth revenue but also for the health and stability of the whole potable spirits industry. The Committee considers that this issue should be of concern to Customs because it is the imposition of high excise rates which produces these potentially unstable conditions in the market.

4.96 The Committee considers that Customs should devote special attention to the collection of excise duties on spirits, particularly in view of the seizure by Customs of an illicit still in Sydney in July this year. In addition to the still which is believed to be the largest illicit one ever found in Australia, Customs officers also confiscated 5000 litres of distilled ethanol spirit representing some \$100,000 in evaded excise duty.

4.97 The Committee considers that an event such as this provides disturbing evidence to substantiate industry disquiet regarding illegal practices. The Committee itself received information which was directly relevant to this matter and views the incident with considerable concern.

4.98 The Committee believes that the Customs investigation of the case may have been hindered by provisions of the Excise Act. The Excise Act which relates to domestic goods provides officers with powers which fall short of those available under the Customs Act which relates to imported goods. For example unlike the Customs Act, the Excise Act provides officers with the authority only to inspect goods and not documents.

7. The Committee recommends that urgent attention be given to increasing the powers exercised by officers under the Excise Act to make them comparable to those exercised under the Customs Act particularly regarding the powers of access to documents. The Committee also recommends that care be taken to safeguard civil liberties and to prevent the possible abuse of powers.

4.99 The Committee is also concerned about the spirits area because the excise rates for spirits are so high that the increase in value due to the imposition of the excise amounts to several times the cost of production of the spirit. Hence once the spirit is in a potable form and duty liability has been incurred the Government in effect has the major 'stake' in that

product. As the producer's 'stake' is lower it is only to be expected that companies acting in their own interests would design controls appropriate to the protection and control of the lower value product. Consequently, the Committee is not convinced by the argument that producers' own commercial interests necessarily ensure adequate control of the products for excise purposes.

4.100 Furthermore, the spirits area represents a difficult control problem for Customs because of the complexity of the production/distribution system. The complexity arises because of the large number of different types of producers and bottlers and distributors. While there are several very large producers there are also many small producers and bottlers. All these factors contribute to making this a high risk area from the point of view of excise collection.

4.101 These control problems also need to be looked at in the light of the value of revenue involved. While approximately \$112 million is collected per annum as excise on spirits, Customs has no reliable way of estimating actual production and therefore actual revenue due. Given the system's complexities and the control difficulties, it is likely that improvements would be labour intensive and therefore expensive. Customs has consistently claimed that independent statistics on production and sales are either not available or not reliable.¹ Furthermore, Customs apparently has not considered independent flow metering for spirits.²

4.102 In these circumstances it seems to the Committee that one remaining course open to Customs is to make improvements progressively in their controls and to monitor each changed procedure to ascertain costs and benefits. In other words Customs should at the very least, have a rigorous system of effectiveness reporting in each State. In this way results should be feeding back to Central Office to allow evaluation of the effectiveness of existing procedures and controls. This should then feed into further adjustments to the control procedures.

4.103 The Committee is concerned that the Department still seems to have difficulty achieving a consistent approach to the treatment of losses across States and across different producers. The Department claims that all losses must be reported and justified but there appear to be enormously varying standards for acceptable losses in different States. For example, during industry inspections, the Committee saw evidence to suggest that much higher bottling losses were considered acceptable in New South Wales compared to South Australia.

4.104 As indicated earlier in this chapter the Committee made several attempts to establish what progress the Department had made on loss control in the spirits area. Overall the

1 Minutes of Evidence, op. cit., p. 387.

2 ibid., p. 379.

Department's responses did not clarify this issue adequately. It appears that the only progress made since the Efficiency Audit has been the acceptance of 20° Celsius as the standard temperature to which all measurements should be corrected.

4.105 The Committee is not convinced that the Department has made adequate efforts to tighten up the problem of spirits loss control since it was raised in the Auditor-General's report. The Committee has been unable to extract any evidence from the Department to suggest that any 'cross-State' comparisons had been made. At the very least State Collectorates could have a lot to learn by exchanging ideas about experiences and methods used in this area. The Committee also considers that the Department should have made more progress towards deciding on the practicality of industry standards.

8. The Committee recommends that a national loss control strategy for spirits should be developed and implemented as a matter of urgency.
9. The Committee reiterates the recommendation of the National Loss Control Working Party that consideration be given to a simplified approach to loss control, involving an adjustment for losses being given in the duty levied.

4.106 The Committee has identified two main arguments in favour of this approach. One argument is that there would be savings in administrative and investigative resources currently used to monitor and check losses. The second positive effect would be that incentive for the producer to minimise losses would be increased if the duty (with the appropriate adjustment) had been incurred as soon as the spirit was received into the spirits receiver and no further allowances could be made. It would then be in the company's commercial interest to control the spirit more securely because its value to the company would include the quite considerable excise component. Any losses would decrease the company's returns much more significantly than is the case under the current system. Currently the commercial incentive to minimise losses only amounts to the cost of production (which is a small part of the 'excise paid' value of the spirit). Currently, the difference between the cost of production and the 'excise paid' value of the spirit, represents the commercial incentive to divert excise-free spirit (such as 'acceptable' losses) to potable uses. Under the proposed system in which duty is incurred earlier than at present, that incentive would not be there for the company after the distillation was complete.

10. The Committee agrees with the views of the Distilled Spirits Industry Council and recommends that spirits bottling only be permitted on licensed premises which are subject to control by the Department. This would eliminate one category of operator, and should reduce the risk of illegal extension of duty paid spirit with duty-free spirit.

4.107 As outlined earlier in this chapter, a significant quantity of pure undenatured alcohol is produced and sold for industrial, scientific and educational applications. This alcohol is excise-free, but is chemically indistinguishable from potable alcohol. The volume of alcohol involved would attract annual excise revenue of the same order of magnitude as that currently collected on potable alcohol. Consequently the potential revenue involved is substantial and the potential for substitution considerable.

4.108 While end users of this alcohol must be registered with the Department and must be 'approved' to receive pure alcohol, the Committee is not convinced that the controls over the disposal of this spirit by end users, are as rigorous as those exerted over the producers. This suggests that there is a real weakness in the system in this area. The Department has advised that as registrations are renewed, each user will be more carefully examined. The Committee is not satisfied however, that sufficient control or surveillance of end users takes place. The Committee considers that this area needs urgent and considerable attention. The end users should be required to maintain proper records of how the alcohol is used and these records should be regularly checked and verified by the Department.

11. The Committee recommends that Departmental resources be applied to ensure proper surveillance and investigation of end users of pure alcohol sold excise-free for industrial scientific and educational applications.

4.109 The Auditor-General in his Efficiency Audit Report¹ stated that:

'the Department proposed in March 1980 the establishment of a Working Party to examine existing controls over 2J spirit and to report upon the efficiency of controls with recommendations for appropriate and feasible changes including an implementation program. Subsequent to the completion of audit fieldwork Audit was advised by the Department that enhanced control procedures had been introduced.'

1 The Efficiency Audit Report, op. cit., p. 53

4.110 The major change on 2J spirit was the introduction of excise at the concessional rate of \$1.50 per litre of alcohol. This duty was removed on 22 June 1984. The Department argues that officers are more diligent about controls when there is some revenue involved than when there are no revenue implications. Such sentiments do not provide much comfort in light of the recent decision to remove the duty. The large discrepancy in the treatment of fortifying spirit compared with other spirits provides a considerable incentive for diversion. Persistent rumours in the industry about abuses in this area add to the Committee's considerable concern about fortifying spirit.

12. The Committee supports the Department's announcement that a review of their spirits operations is currently being undertaken. The Committee recommends that this review be comprehensive and that sufficient Departmental resources be allocated to it to allow it to be completed urgently. The review should pay particular attention to the control of fortifying spirit as well as excise free-spirit used in other applications.

CHAPTER 5

BEER

General Background

5.1 Beer is defined in the Excise Tariff 1901 as any fermented liquor, of more than 0.5% alcohol content by volume, brewed from a mash and containing hops or other bitters.

5.2 Excise on beer is levied by the litre, rather than per litre of alcohol, as is the case with potable spirits. The excise yield from beer in 1983/84 was \$1159 million. It is the second largest source of excise revenue after petroleum products and accounts for 15% of total excise revenue. Six-monthly indexation of excise rates was introduced in the 1983 Budget. The 1984 Budget reduced the rate of excise on beer of not more than 3.8% alcohol by volume but more than 1.15% by volume from 66 cents per litre to 58 cents per litre. Beer of an alcoholic strength in excess of 3.8% faces excise of 66 cents per litre.

5.3 According to Australian Bureau of Statistics (ABS) figures, overall beer consumption fell from 1939.6 million litres in 1981/82 to 1890.7 million litres in 1982/83. This represents a reduction of 2.25% in consumption over the period. It appears that this trend may continue.

5.4 There are currently seven major brewers in Australia, operating from 21 breweries. All are members of the Australian Associated Brewers (AAB), which is the peak council of brewing interests in Australia.

The Brewing Process

5.5 Beer, as defined above, commonly includes ales, lagers and stouts. The variations in the colour and flavour of these beverages result from the use of slightly different raw materials and brewing techniques in each case.

5.6 All raw materials are measured before being added to the production process. The brewers also carry out regular reconciliations of inputs and outputs. Various methods are used in the measurement of liquid product during processing and there appears to be little uniformity between breweries in the types of measurement devices in operation. The range of devices used includes:

- sight glasses on the storage tanks;
- meters - for example, between the fermentation and maturation tanks or between the bright beer tanks and the packaging units; and
- sensors inside the storage tanks.

5.7 The basic commercial brewing process includes four phases: malting, mashing, worting and fermentation.

5.8 Malting

The raw cereal, usually barley, is steeped in water at a controlled temperature then allowed to germinate. Germination enables the development of a number of enzymes required later in the brewing process. When the shoot has appeared, the malt is dried in a kiln until growth is halted or at least retarded. After drying, the malt is cleaned, polished and cured. Malting usually takes place away from the brewery and is often carried out by independent operators.

5.9 Mashing

At the brewery, the ground malt is mixed with warm water in a false bottomed tub to form a mash. Other ground cereals such as unmalted barley, wheat or rice are sometimes added to the mash to introduce particular characteristics. The temperature is raised progressively to enable the enzymes developed during malting to convert the starches into fermentable sugars. The mash is then allowed to settle. The spent grain forms a filter bed through which the liquid, now known as the wort, is drawn off into the wort kettle. The grain is 'sparged' (sprayed) with hot water to separate any remaining wort. This liquid is also drained into the wort kettle.

5.10 Worting

The wort is then brought to boiling point and the hops added, usually in three stages. Hops give beer its characteristic bitter flavour and partially clarify the wort. Boiling concentrates and sterilizes the wort. The process takes about two hours. Immediately after the last addition of hops, the wort is drained from the kettle. The hops are strained and sparged to remove any remaining extract.

5.11 Fermentation

The wort is cooled quickly and yeast added to enable fermentation to occur. The fermentation time varies according to the product desired and the type of yeast used. For example, lager is fermented at up to a maximum temperature of 16°C for about 8-10 days using a yeast that settles on the bottom of the tank. Ale is fermented at temperatures of up to 24°C for 5-8 days using a yeast that rises to the top of the vat. Carbon dioxide, a by-product of fermentation, is sometimes collected during this process for use at a later stage.

5.12 Maturing and Finishing

The new beer is pumped into storage tanks and is maintained under pressure from this point. It is allowed to mature for some time: a minimum of 7 days for draught beer, 14 days for packaged beer. The new beer may be carbonated by allowing controlled secondary fermentation to occur under pressure during maturation. Alternatively, carbon dioxide is injected into the beer as it is filtered. After filtration the product is known as bright beer. If necessary, product is blended to maintain uniformity and de-aerated water may be added to lower the alcohol content. Product that does not meet quality control standards is reprocessed.

5.13. Bulk beer is pasteurised following filtration. The bright beer is then stored in large tanks at low temperature prior to packaging in kegs, bottles or cans. Packaged beer is pasteurised after it is bottled or canned.

5.14. Customs controls are concentrated at the point of packaging. Brewers are obliged to submit new containers to Customs so that their capacities can be established. The kegs, into which the beer from the bright beer tanks is pumped, are counted manually and the number and size of the kegs is recorded by the company. The product is then moved into on site storage facilities under Customs control. In the case of canned and bottled beer triple-banked pressure-sensitive counters are used to record the number of filled containers produced. The counters are locked and the keys are held by Customs. All losses after counting must be accounted for. Refunds of excise duty are allowed on bulk beer if the beer is unfit for consumption and not more than one eighth of the content has been removed. No refunds are allowed on packaged beer.

5.15. Excise on beer is assessed by multiplying the dutiable quantity in litres by the excise rate. Dutiable quantity is assessed by multiplying the number of containers by their average volume. Excise duty is collected when the product is entered for home consumption. All losses between packaging and payment of duty must be accounted for to Customs. The smaller breweries usually enter product directly into home consumption as it leaves the factories. However, considerable under-bond movement of product occurs from the major breweries.

The Auditor-General's Comments

5.16. In the Efficiency Audit Report, Audit observed that for beer, Customs concentrates its resources at the packaging stage. Audit questioned whether revenue was adequately protected under these arrangements. The possibility of diversion of product between the bright beer and the packaging stages was discussed.¹

5.17. Audit suggested that, if the point of excise liability were to remain at the packaging stage, the Department should assess the need for improved upstream checks. Considerations raised by Audit included:

- the possibility of reconciling raw material and/or production processing data with final yield data (recognising the considerable variability which characterizes the brewing process); and
- the significant losses between the bright beer and packaging stages - these vary between 2% and 3.5% on Audit's observation and are not subject to systematic departmental verification.

1 The Efficiency Audit Report, op. cit., p. 44, 45.

5.18 Audit suggested that liability for excise duty on beer might be calculated at the bright beer stage. If this were done, an allowance for losses after the bright beer stage could be built into the calculation of excisable quantities. This would provide an additional incentive for manufacturers to minimise losses and maximise security against diversion.

5.19 In its response to Audit during the Efficiency Audit, the Department indicated that:

considerable difficulties existed in accounting for product at the bright beer stage;

- the tanks were not calibrated sufficiently accurately for measurement purposes;
- bright beer was often recycled through the production process or extended with water when the alcohol content was too high;
- excise was payable only on product that went into home consumption, not on production wastes; and

diversion of bright beer was highly unlikely as it would require conspiracy by senior management.

5.20 Audit responded that use of accurate sealed measuring devices at the bright beer stage would overcome most accounting problems. The National Measurement Laboratory which was consulted on the possible use of measurement devices at the bright beer stage considered that unless the volume of bright beer produced was accurately measured, Customs would be unlikely to detect any diversion of product. Audit stated that preliminary enquiries had indicated that appropriate measurement devices could be purchased for approximately \$2,600. However, the Laboratory agreed with Customs' view that diversion was unlikely and would require conspiracy at a high level.

5.21 Audit¹ recommended that:

- (i) Consideration should be given to assessing liability for duty at the 'bright beer' stage of production.
- (ii) Additional independent checks of production quantities should be undertaken to provide assurance of adequate accountability for product. This should be achieved by use of devices for measuring product volumes where increased assurance is deemed warranted.
- (iii) Check programs should be designed to validate the adequacy of the producers' accounting and

recording systems rather than to detect clerical errors. Effectiveness monitoring should be re-directed to evaluating the reliability and accuracy of control systems and revenue protection away from the current emphasis on clerical checking of documentation.'

5.22 Audit¹ also recommended:

- the use of independent production volume data, such as ABS statistics, to validate beer excise duty collections
- promulgation by Central Office of detailed guidelines on appropriate field checking methods to validate production losses between the bright beer and packaging stages
- application of a suitable risk management process in a systematic way.

Departmental Response

5.23 The Department's response to Audit's recommendation that consideration be given to relocating the point of excise liability on beer to the bright beer stage, was guarded at first. In its initial submission to the Committee, the Department accepted that meters could be used to ascertain the volume of bright beer.² Acceptance was based on discussions held with the AAB and one meter supplier. However, meters were seen to be costly and inaccurate. The point was also made that as diversion at the bright beer stage would require collusion within senior management, meters would not necessarily prevent diversion of the product.

5.24 In its submission of August 1983,³ the Department rejected Audit's recommendation on the following grounds:

- the industry strongly objected to the proposition;
- there was no evidence and little likelihood of diversion of product at the bright beer stage;
- there was no loss to revenue involved in waste losses during the beer production processes;
- there were doubts whether knowledge of the quantity of bright beer produced would provide greater assurance that the revenue was protected as production wastes could not be measured; and
- transfer of excise liability upstream would require more Customs resources and could not be cost effective.

1 The Efficiency Audit Report, op. cit., p. 45.

2 Minutes of Evidence, op. cit., p. 18.

3 ibid., p. 18.

5.25 Audit's recommendation for additional independent checks of production quantities using measuring devices received a similarly guarded first response. As set out above, the Department accepted that meters could be used for measurement purposes, but questioned their practicability. Production losses between the bright beer and packaging stages were seen to present a particular problem as they were not adaptable to measurement. The Department reiterated that manufacturing losses were not revenue losses - which Audit had recognised - and were therefore the responsibility of the manufacturers, not the Department.

5.26 Further to that response, the Department¹ rejected Audit's recommendation on the use of meters at the bright beer stage on the following grounds:

- acceptance of the Australian Association of Brewers' objections to the use of meters (see later in this chapter); and
- perceived legal problems relating to ownership, installation, access to meters and the cost factor.

5.27 In response to Audit's recommendation that check programs be designed to validate the adequacy of the producers' accounting and recording systems as opposed to checks for clerical errors, the Department cited the planned introduction of systems based investigations (see Chapter 3).

5.28 In September 1982² the Department outlined the grounds for rejecting the use of ABS figures to validate the amount of excise duty collected on beer, on the basis that:

- the data do not include statistics on duty-free, export, under-bond storage, breakage and return quantities; and
- where information is available on exports, under - bond storage quantities, etc. it cannot be related to particular production runs.

5.29 The Department referred again to these reasons for rejecting use of ABS data in its submission of August 1983.³ It claimed that a detailed feasibility study had been carried out on the use of the figures and that no alternative sources of data had been identified. However, at the public hearing of 7 May 1984, the Department stated that it was following up the possibility of using industry figures for reconciliation purposes.⁴

1 Minutes of Evidence, op. cit., p. 314, 315.

2 Information supplied on 16 September 1982 by the Department of Industry and Commerce in response to questions raised by the Committee at the June 1982 hearings (Submission No. 9).

3 Minutes of Evidence, op. cit., p. 316, 387.

4 ibid., p. 581.

5.30 The Department argued that Audit's recommendations that:

- Central Office promulgate detailed guidelines on appropriate field checking methods to validate production losses between the bright beer and packaging stages; and
- a suitable risk management process be applied in a systematic way

were being implemented through the introduction of risk management and systems based investigation programs. At the time of writing, one brewery had been investigated using systems based investigation techniques and was found to have strong internal controls. The Department planned to examine another five breweries during 1984. The Department informed the Committee on 11 May 1984 that risk management had not yet been applied to the brewing industry.

Industry Response

5.31 During the Inquiry, the Committee visited Carlton and United Brewery's Abbotsford plant and the Northern Territory Brewery Pty Ltd. The latter is an approved place for the storage and distribution of packaged beer. The AAB made a submission to the Committee and gave evidence at a public hearing in June 1982.

5.32 The Association was critical of the Auditor-General's Report on a number of grounds including:

- lack of consultation with the industry;
- false imputations of product diversion without evidence;
- lack of understanding of the processes which take place after the bright beer stage;
- use of overseas practice in support of its findings without citation of evidence to support relative costs and benefits;
- suggested use of meters where adequate yield assessment techniques are already in place; and
- understatement of the cost of measurement devices.

5.33 The AAB opposed Audit's suggestion that liability for excise duty on beer could be moved upstream to the bright beer stage. This position was taken for the following reasons:

- it would involve huge increases in working capital costs leading to sharp rises in retail prices;

- Audit's assumption that bright beer is a finished product and therefore marketable, is not accurate;
- the companies already account to Customs for losses both before and after packaging; and
- overseas experience has shown that the factory gate is the most efficient point for excise duty collection.

5.34 The AAB also strongly opposed the introduction of sealed measurement devices at the bright beer stage for either excise collection purposes or for production monitoring. It acknowledged that flow meters were already in place in some breweries but stated that these are not used where accurate measurement is required. Meters for Customs purposes were seen as:

- too expensive (an estimate of \$4.5 million for the industry as a whole was suggested);
- inaccurate, for example because of the need to reprocess some bright beer, flush the pipes for cleaning purposes;
- unhygienic;
- expensive to maintain and recalibrate; and
- requiring full-time Customs supervision.

5.35 The AAB submission made several general points. It supported commodity control as cost efficient and effective and denied that any diversion of product takes place between the bright beer and packaging stages noting that Customs controls are in fact concentrated at the packaging stage. The submission also pointed out that the companies already carry out upstream audits and reconciliations of inputs and yields.

5.36 Towards the end of this inquiry the Committee sought the industry's views on the specific proposal that excise duty be collected at the point of packaging, rather than at entry for home consumption. The Committee received comments from the AAB and Cooper and Sons Limited expressing their concern at the possible consequences of the Committee's proposal, which in effect would rule out storage and movement of products under bond. Representatives of both the AAB and Cooper and Sons Limited reiterated the views at the public hearing held on 19 July 1984.

5.37 Cooper's particular concern was that ale and stout, which account for approximately 50% of their sales, continue to ferment after bottling. During this time the products must be

stored and are unfit for sale. Storage in cellars may last up to 6 weeks. Coopers also claimed that they transport a significant proportion of product interstate which increases the time the product remains under bond.

5.38 The AAB also rejected the proposal arguing that the widely differing operating strategies of brewers including the differing under-bond dwell times for different producers' product, would cause inequities under any offsetting arrangements. The AAB was also concerned that such a move would distort the current balance between production and storage facilities because of the higher cost of holding excise-paid stock. Instead, the AAB suggested discussions between the industry and the brewers on the introduction of a computer-based monitor system for under-bond movement and storage of product.

Audit's Response to Industry Criticism

5.39 In its submission of 11 June 1982 to the Committee, Audit commented on the AAB's criticisms of the conduct of the Efficiency Audit.

5.40 Audit remarked that, given the scope of the Efficiency Audit, it would have been inappropriate to have undertaken in depth consultations with the industry. It saw its role as assessing the adequacy of the controls used by the Department for protecting revenue. Where deficiencies had been identified, possible improvements had been suggested for consideration by the Department.

5.41 Audit claimed that in accordance with its brief it had identified the possibility of diversion of product between the bright beer and packaging stages. It had not implied or asserted that such diversion was taking place. Audit commented that if upstream audits of input and yields were already carried out by industry and if such audits gave an objective indication that diversion was not taking place, then measurement at the bright beer stage would be less necessary.

5.42 Although the AAB claimed that measurement of product at the bright beer stage would be difficult in view of the additional processes undertaken after that point, inspection by Audit had confirmed that there were only three or four pipes running from the bright beer tank to the packaging stage.

5.43 Audit stated that it had referred to overseas practice in order to place Australian practice in context rather than necessarily to support its own suggestions. Audit did note, however, that some references made to overseas practice in the AAB's submission, including its reference to the use of metering systems in the United States as a check on production losses, in fact supported some of Audit's recommendations.

5.44 Audit suggested that an independent expert report might be sought on the question of metering, given the significant differences in opinion expressed by Audit and the AAB.

The Committee's Comments and Recommendations

5.45 As previously noted, excise duty on beer forms a major part of the total excise revenue collected by the Government. Consequently, ensuring that the revenue due from excise on beer is sufficiently protected should be a high priority with the Department.

5.46 The Committee considers that from the viewpoint of administering the collection process, duty on beer would be better collected at the packaging stage rather than at the point of entry into home consumption, as occurs under current practice. Bulk beer is usually consumed soon after production. The shelf life of packaged beer is quite short: approximately three months in bottles, six months in cans. Consequently, dwell times in bond should not exceed these periods. The Committee expects that this approach would result in some savings in staff resources applied to the supervision of beer products stored and transferred under bond. The main advantage would lie in decreasing the time the product is under Customs control, thereby diminishing the opportunity for diversion prior to payment of excise duty.

5.47 The Committee appreciates the point made by industry that given the widely differing warehousing policies by brewers and Cooper's maturation requirement, the proposal may discriminate between firms. Against this negative feature, the proposal has the positive effect of reducing the number of controlled premises and the number of under-bond movements. On balance the Committee considers it appropriate to suggest that excise be paid when the product leaves the brewery. This proposal would eliminate under-bond sales to other parties and go some way towards meeting the competing objectives of improving control procedures and minimising the burden on industry.

5.48 The Committee recognises that moving the point of excise collection may cause some inconvenience and cost to the industry, resulting from:

- commitment of capital resources to the storage of excise-paid product; and
- payment of excise on product subsequently used for duty-free purposes.

5.49 The Committee suggests an extension of the settlement period for duty payment to compensate the industry for the additional financial costs incurred due to the earlier point of collection. The extension should be based on the average length of time that stocks are held under bond under current arrangements. Industry representatives would need to be closely

involved in the determination of an appropriate extension of time. Cooper and Sons, for example, have indicated that 50% of their production is ale and stout which require several week's fermentation in bottles to complete the production process. Such issues would need to be considered when determining the period of duty payment.

5.50 To ensure that local product is not disadvantaged by implementation of the proposal, customs duty could be collected on imported beer, with an appropriate credit period, after release from the initial warehouse into which goods are entered upon importation. Under-bond transport to further warehouses would not be allowed.

5.51 The Committee stresses that its intention in suggesting a shift in the point of excise collection is to free Customs resources for more cost-effective purposes. The Committee would not wish to see the resources which had been freed then diverted to the assessment of post-production losses. Control of post-production losses should, in the Committee's view, be the responsibility of the companies. The Committee believes that Customs resources could be used more effectively in areas other than the validation of loss claims. All consideration of losses could be eliminated by incorporating an automatic, fixed percentage adjustment to production volumes in the calculation of excise liability. The adjustment should be calculated on the basis of average losses in the industry over recent years.

5.52 The current rebate system for excise-paid, duty-free and export sales could well remain appropriate under the proposed system.

5.53 While the Committee has given some consideration to the possible consequences of the proposed shift in the point of excise collection on beer, it hesitates at recommending that such a modification be instituted. The Committee concludes that the area of alternative methods of excise collection be given more detailed examination. This examination should canvass alternative methods of collecting excise on beer, including the particular proposal that:

- excise duty on beer be collected at the point where the product leaves the brewery in accordance with the general principles outlined in Chapter 3;
- the settlement period for payment of excise duty be extended to compensate industry for the increased costs involved in the proposal;

- the length of the extension be established by the Departments of the Treasury, Finance and Industry and Commerce in consultation with industry;
- loss validation be replaced by an automatic, fixed percentage adjustment to the production volume assessed as excisable; and
- the present rebate system for excise-paid, duty-free and export sales remain.

5.54 Whether or not the Committee's suggestion to move the point of excise collection upstream is accepted, metering remains an important question. The Auditor-General pointed out in his Efficiency Audit Report that Customs was unable to assess independently the amount of revenue due and therefore was unable to assess the effectiveness of its revenue collection controls. The situation has not changed materially during the course of this inquiry, particularly since no advances appear to have been made with the identification of independent data sources. Furthermore, the Committee is not convinced that the Department has made an adequate technical assessment of this issue.

5.55 The Committee accepts the Customs and industry view that diversion of bright beer is unlikely and that liability for excise duty on beer should be assessed at the packaging stage. Consequently, the Committee has not pursued Audit's recommendation that meters be installed at the bright beer stage. However, the Committee is most concerned that the Department has not approached the investigation of other sources of data for reconciliation purposes, such as ABS retail figures, enthusiastically. Until Customs is able to make independent estimates of the amount of revenue due, it is in no position to assess how effective its controls are. The Committee was interested to learn that the industry already carries out reconciliation exercises of inputs and outputs (see earlier this chapter). The Committee welcomed Customs' preparedness to look at the results of these exercises. The Committee considers that, given the amount of revenue involved, Customs should give a high priority to establishing independent estimates of revenue.

13. The Committee recommends that Customs readdress the Auditor-General's recommendations on the possible use of independent sources of data to develop a means of estimating potential revenue due.

5.56 As is the case with other commodities, the Committee is concerned at the length of time taken by Customs to commence implementation of the Auditor-General's recommendations on risk management and systems based reviews in the brewing industry. While the Department mentioned both programs in its initial submission to the Committee in 1982, at the time of writing risk management had not been introduced into the brewing industry and systems based reviews of breweries were just commencing.

5.57 As the excise derived from beer is such a major source of excise revenue,

14. the Committee recommends that adequate resources be made available to the Inland Revenue and Dumping Division to enable prompt implementation of systems based reviews in the brewing industry.

CHAPTER 6

TOBACCO

General Background

6.1 Excise duty is levied on all manufactured tobacco products. The excise yield from tobacco products in 1983/84 was approximately \$869 million or approximately 21% of total excise revenue. Duty derived from cigarettes is the most important element of tobacco excise; it amounted to \$828.1 million in 1983/84. Customs duty is also levied on imported tobacco: revenue from this source amounted to \$44 million in the same year.

6.2 As previously noted, indexation of excise rates was introduced in the 1983 Budget. As from 21 August 1984, excise on cigars and cigarettes is levied at the rate of \$32.25 per kilo of tobacco. The 1984 Budget announced a discretionary increase in excise on manufactured tobacco by \$5 per kilo to \$25.92 per kilo.

6.3 There are three major manufacturers of cigarettes and other tobacco products in Australia: W.D. & H.O. Wills (Australia) Ltd, Rothmans of Pall Mall (Australia) Ltd and Philip Morris Ltd.

The Tobacco Industry

6.4 Tobacco is grown in areas of Queensland, Victoria and New South Wales. Growers must be registered with the Department of Industry and Commerce. The Australian Tobacco Board, in association with the State Tobacco Leaf Marketing Boards and the Australian Agricultural Council, regulate the production and marketing of all but a small percentage of tobacco leaf by the imposition of quotas and by fixing prices. Substantial Australian content in manufactured tobacco products is actively encouraged by the application of concessional rates of customs duty on imported tobacco where the local finished product contains at least the specified percentage of local leaf. Currently this percentage is set at 50% by law, but an agreement between the Australian Tobacco Board and the growers sets the actual level at 57%.

6.5 The manufacturing process for cigarettes is a relatively simple one. The manufacturer makes an initial declaration to Customs of the standard weight of each brand of cigarette. Local and imported leaf is held in store under Customs control until ready for use. It is requisitioned from store in appropriate amounts for each brand, weighed and a Customs entry made out for the weight of imported leaf entered into production. Customs duty is paid at this point on the imported leaf. The bulk leaf is then progressively mixed, shredded, flavoured if necessary and cut for use in the cigarette-making machines.

6.6 Production is generally monitored electronically to ensure that the weight of each cigarette corresponds with the declared weight for that brand. Sample batches of cigarettes are then test-weighed in lots of 500 to ensure that they fall within a statistically acceptable margin of the standard weight. Rejected cigarettes are returned to the manufacturing process and all waste must be accounted for to Customs. The cigarettes are packaged into standard sized cartons and then containers. At this stage, they are considered by Customs to be excisable goods. Excise liability is assessed by multiplying the number of cigarettes by the declared standard weight for each brand.

6.7 The containers are counted manually and the number of cigarettes recorded by the company for its records. The containers are then taken from the factory to the licensed warehouse. Where necessary, the goods are transferred to other localities under bond. This generally takes place under continuing permission arrangements (see Chapter 7). Records of all product movements must be maintained for Customs inspection. Excise is paid when the goods are entered for home consumption.

The Auditor-General's Comments:

6.8 The Auditor-General¹ identified three broad control measures that are required of manufacturers of tobacco products under the commodity control system:

- . accurate declaration by companies of the weights of tobacco products liable for duty and company control over deliveries;
- . company control over the weighing of imported tobacco and the use of at least 50% Australian tobacco; and
- . regular reconciliation of physical inventory stocktake results against book stocks for raw materials and for packaged stocks.

6.9 As a part of the Efficiency Audit the Auditor-General sought advice from the National Measurement Laboratory on the adequacy of measurement procedures and processes used in tobacco factories. After an inspection of a tobacco company Mr Bell of that Laboratory made the following observations:²

- . the company should be asked to produce the relevant calibration report for the weights used to verify the special weights employed in the batch weighing of cigarettes; and

1 The Efficiency Audit Report, op. cit., p. 58.

2 ibid., p. 20.

the balances used in the laboratory and for the final test weighing should be regularly serviced and certified by a National Association of Testing Authorities (NATA) registered laboratory.

6.10 The Auditor-General recommended¹ that:

- more attention be given to assessing material balances and to the use of systems based checks;
- greater attention be paid to the reconciliation of the available raw material data with production data; and
- Central Office should examine alternative sources of data on production volumes, particularly Australian Bureau of Statistics (ABS) retail data, to provide checks on revenue due.

6.11 Of particular relevance in the tobacco area are the Auditor-General's recommendations on Inland Services' management system.² These covered the collation of information on the technical production and distribution systems for each commodity, the development of commodity risk management operating policies and the application of systems-based investigation methodologies to validate companies' own reporting and control systems.

Departmental Response

6.12 In response to Audit's general recommendations Customs selected tobacco products for its first industry review. Tobacco was seen as a small, well-controlled industry on which to test new approaches. The tobacco review report, 'Tobacco Growing and Manufacturing in Australia' was completed by the Inland Services Branch in April 1983. It includes examinations of the tobacco growing and manufacturing processes, commodity control in the industry and the recommendations of the Efficiency Audit Report. The tobacco report contained 12 recommendations of which six were accepted and four are under consideration by a small Departmental working party which has Central Office and State membership.³

6.13 The Department also selected a tobacco company on which to test the systems based investigation techniques being developed through the Touche Ross consultancy. To this effect a pilot exercise was carried out in 1983 on the tobacco manufacturer, Rothmans of Pall Mall (Australia) Ltd. The aim was to demonstrate the effectiveness of systems based audit techniques in revenue-gathering areas and to gain some experience in their use. In systems based auditing, the client's management and accounting systems - including, for example, forms, records, procedures and devices used to process data - are studied in detail then tested for their effectiveness in the control of product and the protection of Commonwealth revenue. Both manual and ADP systems are reviewed and potential risk situations are

1 The Efficiency Audit Report, op. cit., p. 12, p. 58.

2 ibid., p. 36.

3 Minutes of Evidence, op. cit., p. 575.

the balances used in the laboratory and for the final test weighing should be regularly serviced and certified by a National Association of Testing Authorities (NATA) registered laboratory.

6.10 The Auditor-General recommended¹ that:

- more attention be given to assessing material balances and to the use of systems based checks;
- greater attention be paid to the reconciliation of the available raw material data with production data; and
- Central Office should examine alternative sources of data on production volumes, particularly Australian Bureau of Statistics (ABS) retail data, to provide checks on revenue due.

6.11 Of particular relevance in the tobacco area are the Auditor-General's recommendations on Inland Services' management system.² These covered the collation of information on the technical production and distribution systems for each commodity, the development of commodity risk management operating policies and the application of systems-based investigation methodologies to validate companies' own reporting and control systems.

Departmental Response

6.12 In response to Audit's general recommendations Customs selected tobacco products for its first industry review. Tobacco was seen as a small, well-controlled industry on which to test new approaches. The tobacco review report, 'Tobacco Growing and Manufacturing in Australia' was completed by the Inland Services Branch in April 1983. It includes examinations of the tobacco growing and manufacturing processes, commodity control in the industry and the recommendations of the Efficiency Audit Report. The tobacco report contained 12 recommendations of which six were accepted and four are under consideration by a small Departmental working party which has Central Office and State membership.³

6.13 The Department also selected a tobacco company on which to test the systems based investigation techniques being developed through the Touche Ross consultancy. To this effect a pilot exercise was carried out in 1983 on the tobacco manufacturer, Rothmans of Pall Mall (Australia) Ltd. The aim was to demonstrate the effectiveness of systems based audit techniques in revenue-gathering areas and to gain some experience in their use. In systems based auditing, the client's management and accounting systems - including, for example, forms, records, procedures and devices used to process data - are studied in detail then tested for their effectiveness in the control of product and the protection of Commonwealth revenue. Both manual and ADP systems are reviewed and potential risk situations are

1 The Efficiency Audit Report, op. cit., p. 12, p. 58.

2 ibid., p. 36.

3 Minutes of Evidence, op. cit., p. 575.

rated according to the likelihood of 'errors' occurring: in this case, the failure to collect revenue. Rothmans' production sales system was also checked using computer audit software.

6.14 The techniques demonstrated during the pilot study were found to be effective. However a small underpayment of \$52,187.64 excise duty was discovered and two minor weaknesses in the accounting system were identified, viz receipts of leaf into store were not signed for as evidence of goods received against documentation, and there was a general lack of an effective audit trail in the newly computerised daily sales and stock statements. These problems were rectified by the Company.

6.15 The Department did not directly address the Auditor-General's suggestion regarding comparison of measurements taken during the production process and at the final test-weighing in either its submission of 24 May 1982¹ or in its submission of 12 August 1983.² However, in the tobacco review report Inland Services stated that this check was already carried out in some investigations and recommended that it be included in all investigation programs.³ At a later public hearing,⁴ this matter was said to be under consideration by a working party investigating excise controls over tobacco products.

6.16 Audit's suggestion that the material balances used in the laboratory and scales used for the final test weighing should be regularly serviced and certified by a NATA registered laboratory was accepted by the Department in its submission of 24 May 1982.⁵ The tobacco review report recommended its implementation and claimed that it was included in some current control procedures.⁶

6.17 The Department's response to the recommendation that raw material data be reconciled with production data as a check on the amount of excise that could be expected to be collected was less positive. The Department claimed in its submission of 24 May 1982 that such an approach was impractical because tobacco is susceptible to variations in moisture content.⁷ The use of ABS production data was rejected because Customs supplies this data to the ABS and it is not, therefore, considered to be sufficiently independent to be of use.⁸

1 Minutes of Evidence, op. cit., p. 33.

2 ibid., p. 320.

3 Department of Industry and Commerce - Australian Customs Service Tobacco Growing and Manufacturing in Australia Canberra 1983 p. 64, p. 2.

4 Minutes of Evidence, op. cit., p. 575.

5 ibid., p. 33.

6 Tobacco Growing and Manufacturing, op. cit., p. 64, p. 2.

7 Minutes of Evidence, op. cit., p. 33.

8 ibid., p. 387, and information supplied on 16 September 1982 by Department of Industry and Commerce in response to questions raised by the Committee at the June 1982 hearings (Submission No. 9).

6.18 Subsequently, Audit's suggestion for reconciliation of raw material and production data was accepted by Inland Services in the tobacco review report¹ and in the Department's submission of August 1983.² This apparently followed the discovery that the tobacco companies already carried out checks of this sort for production accounting purposes. At the time of writing, this recommendation was also under consideration by the tobacco working party.

6.19 The Department rejected Audit's recommendation that Central Office should examine alternative sources of data on production volumes after examination of the problems associated with the use of ABS retail data.³ It was established with ABS that their retail figures are based on sales value. As retail sale prices differ so much for the same items, the Department claimed that the data would be useless for comparative purposes.

Industry Response

6.20 Submissions were sought from the industry at the commencement of the inquiry in 1982 and when it resumed in 1983. All manufacturers argued for maintenance of the status quo in the basic system of collection of tobacco excise.

6.21 W.D. & H.O. Wills (Australia) Ltd and Philip Morris Ltd accepted Audit's suggestion that material balances be serviced and certified by a NATA registered laboratory.

6.22 W.D. & H.O. Wills argued at some length that the present means of assessing cigarette excise on a dollars per kilo basis is preferable to collection on a cents per cigarette basis on the grounds that:

- . the present system is efficient;
- . the cents per stick approach would discriminate against lighter cigarettes; and
- . to change would substantially increase the cost of the product to consumers.

The Company also stated in its submission that it reconciles the amount of leaf that goes into the manufacturing process with production output figures twice yearly.

6.23 Philip Morris suggested a number of minor changes that they claimed would not affect revenue but would streamline the system from their point of view. These included:

1 Tobacco Growing and Manufacturing, op. cit., p. 64.

2 Minutes of Evidence, op. cit., p. 320.

3 Information supplied on 16 September 1982 by Department of Industry and Commerce in response to questions raised by the Committee at the June 1982 hearings (Submission No. 9).

- a standard allowance for production losses be agreed between Customs and the companies (at present all losses during production must be accounted for);
- assessment of excise on the average declared weight of all cigarette brands, rather than on each brand as is currently the case;
- adoption of a moisture standard of 11% as the basis for calculation of standard declared weights - this is current practice at Philip Morris and, in their view, should be formalized; and
- calculation of the declared weight of cigarettes at the point where duty is payable (when the goods are entered for home consumption) - this is also a current practice which the Company would like formalized.

6.24 At the time of writing, the tobacco working party referred to earlier in this chapter, was examining these suggestions. However, during an in camera hearing, Customs indicated that the first two Philip Morris suggestions could have revenue implications.

6.25 As part of its inquiry the Committee sought the industry's response to the suggestion that excise duty be collected at the point of packaging. The Committee recognised that this would cause a considerable increase in costs for the industry and suggested that the duty settlement period could be extended to offset those extra costs.

6.26 The industry identified a number of problems involved in the possible implementation of the procedure including,

- increases in costs, due to increase in value of excise-paid stocks prior to distribution;
- discrimination against local producers compared with importers who could locate non duty-paid stock around Australia;
- discrimination against small stock lines that are manufactured infrequently and held for long periods;
- the discouraging of stockpiling; and
- difficulties in obtaining refunds on duty-free stocks.

6.27 Two manufacturers identified the possibility of collecting excise at the factory gate rather than at the point of packaging. However, such an approach would disadvantage manufacturers who lack large storage facilities at the factory site.

6.28 Philip Morris Ltd, supported the proposal to collect excise at the point of packaging and offered to participate in an experiment to test this approach. W.D. & H.O. Wills (Australia) Ltd and Rothmans of Pall Mall (Australia) Ltd were not in favour of a change in the point of collection of excise and supported the continuation of the present system.

The High Court Cases of 1969 and 1973

6.29 During the course of the inquiry, the Committee received information that during the 1960s an attempted reconciliation of records had shown substantial discrepancies between entries for warehousing of imported tobacco products and entries for home consumption for the same products. In response to the Committee's request for details of the reconciliation exercise and follow-up action taken, the Department provided copies of two High Court judgements: Chipp vs Campbell Beaumont Trading Pty Ltd and Others (Barwick C.J. 1969) and Murphy vs Campbell Beaumont Trading Pty Ltd and Others (Barwick C.J. 1973).

6.30 The first was a prosecution under the Customs Act 1901 for false entry of information relating to the importation of cigars, evasion of duty, intent to defraud the revenue and smuggling. In essence:

- the case concerned 1,360 entries of cigars ex warehouse for home consumption, and 60 entries of cigarettes ex warehouse for home consumption;
- the defendants apparently became aware in about 1948 that Customs in Sydney did not physically check the weights of cigars entered for home consumption;
- their business was based at that time on importation of cigars into Melbourne, where physical checks were a regular feature of Customs controls;
- it was alleged that Customs in Sydney used a schedule of conventional weights in checking entries to home consumption; the defendants had obtained a copy of a schedule of this kind, although Customs denied its existence;
- the defendants moved their cigar importation business to Sydney;
- in Sydney the imported cigars were correctly entered for warehousing at the manufacturer's weight;
- some time later they were entered for home consumption at the conventional weight cited in the schedule, which was always less than the manufacturer's weight;

- although the Customs officers had the entries for warehousing to hand, the entries for home consumption were stamped 'Particulars Correct' in each case and passed;
- goods to the value of \$1,872,000 were involved and the amount of duty evaded was \$343,326;
- Barwick C.J. found the defendants guilty on the charges relating to false entry and evasion of duty but not on the charges relating to intention to defraud the revenue and smuggling;
- he found that the Customs officers involved had been negligent in accepting the conventional weights without physical check and was disposed to accept the defendants' claim that a schedule of conventional weights existed; and
- he did not consider that their conduct necessarily involved intent to defraud.

6.31 The second case was very similar to the first. It related to 692 entries for home consumption for cigars imported between December 1965 and 1968 which had apparently been omitted from the original charges. The total value for duty of the cigars involved was \$1,005,855.89. The duty evaded amounted to \$187,548.57. During the case Customs conceded that a register of conventional weights existed and that officers used the register to check the weights of cigars entered for home consumption. In his Judgement, Barwick C.J. repeated his earlier comments on the conduct of the officers involved.

Speculative Clearances of Products Prior to the 1983 Budget

6.32 Another matter which came to light during the inquiry, was the unusually high movement of tobacco products which had taken place prior to the Treasurer's Economic Statement of May 1983 and also prior to the imposition of pre-Budget quota controls on 22 June 1983. Quota controls limit the amount of product that companies can clear from Customs control during a specified period and are based on an assessment by Customs of average weekly clearances by each company over a previous period. The sample period is usually of about four months' duration to enable a reasonably accurate estimate of clearance patterns.

6.33 There was no increase in excise rates announced in the May 1983 Treasurer's Statement. However, an increase of \$1.28 per kilo on cigarettes and six-monthly indexation of excise rates was announced in the 1983 Budget. Therefore, while companies gained no advantage from their speculation prior to the May Statement, a substantial saving in excise payments was made by the companies through pre-Budget speculation. Clients who placed large orders for stocks just prior to imposition of the controls achieved an advantage over their competitors.

6.34 The pre-Budget quota controls were imposed nine weeks before the Budget - the longest period ever. Extremely large clearances or tobacco products were made on the two days preceding the imposition of the controls, taking the clearances for that week to more than twice the June weekly average. Unusually high clearances of spirits were also made on those two days. This speculation was not investigated by Customs. The reason given for the decision not to investigate the matter was that the large number of people (and Departments) involved in imposition of the quotas meant there would only be a slight chance that the illegal disclosure of information could be traced.

6.35 In May 1984, following Parliamentary comment, the matter was referred to the Australian Federal Police for investigation.

6.36 It should be noted that the speculative clearances were not illegal; excise duty was paid at the appropriate rate in each case. However, had the additional clearances not been made, the Government could reasonably have expected approximately \$600,000 more in revenue from excise on cigarettes after the 1983 Budget.

The Committee's Comments and Recommendations

6.37 It may be tempting to dismiss the issue of Customs control over tobacco products on the grounds that there is heavy Government regulation of tobacco production and marketing and a limited number of manufacturers. However, the considerable size of these manufacturing operations, the magnitude of the associated excise liability and the significance of the possible gains or losses to revenue make it an extremely important area of control. Thus, while tobacco could be considered an area of comparatively low risk, it is extremely important for Customs to be quite certain of the effectiveness of its controls.

6.38 As discussed earlier in this chapter, since the release of the Auditor-General's report in 1982 the tobacco industry has been used by Customs as a testing ground for its new approaches to excise control. Given the prominence Customs has placed on the industry, the Committee is surprised at the difficulty apparently experienced in formally introducing even the simple control measures recommended by Audit. These include the recommendations relating to checking material balances, reconciliation of production and final test weighing data and reconciliation of raw material data with production data.

6.39 In view of the large amount of excise revenue derived from tobacco products, both in absolute terms and as a percentage of total excise revenue, the Committee considers that more attention should be paid to the establishment of an independent means of estimating the revenue due from excise payable on tobacco products. The Committee recognises that there are problems associated with the use of, for example, ABS retail data

for this purpose. However, the Department could take a more constructive and imaginative approach to solving these problems. While it may be impossible to find a completely accurate and independent source of data, it should be possible to use ABS material to derive useful estimates.

15. The Committee therefore recommends that the Department devote greater effort to the identification and use of alternative sources of data on production volumes in order to estimate the excise revenue due from tobacco products.

6.40 The Committee welcomes the progress made by Customs during the past twelve months in the development of systems based investigation techniques in the tobacco industry. It is, however, a matter of some concern to the Committee that vital planning and development resources were made available to the Inland Revenue Division only after it came under scrutiny by Audit and this Committee. The Committee is also concerned to ensure that once the initial systems investigation of a company has been completed, follow-up checks, based on the results of the original investigation, are made regularly.

16. The Committee recommends that adequate resources be made available to increase the current rate of progress in the development of systems based investigation techniques in the tobacco industry and to allow regular review of companies' systems.

6.41 The Committee agrees with the industry's and Customs' view that the current method of calculating excise duty on cigarettes on a dollars per kilo basis is the more appropriate method. In relation to industry's other proposals, the Committee agrees with Philip Morris Ltd's suggestion that the declared weight of cigarettes be calculated where duty is payable. It is not, however, convinced that the Company's suggestions regarding standardised loss allowances and assessment of excise on an average declared weight for all brands, would have no effect on revenue. Nevertheless, the Committee believes that the Department should give consideration to Philip Morris' suggestions.

6.42 The High Court cases referred to earlier illustrate the problems caused when documentary checks are inadequate. The Committee is not convinced by Customs' claims that the introduction of commodity control in the tobacco area necessarily precludes a recurrence of the particular problems to which the cases referred. Customs and excise duty on manufactured tobacco products is still calculated by multiplying the number of cigarettes by the declared weight of each brand. Entries,

releases and stocks in bonded warehouses are still not properly reconciled. Currently, Customs relies very heavily on the records of importers (who are usually also manufacturers) to establish how much product should be on hand at any one time. The High Court cases illustrate the importance of combining the computer system that records entries into licensed warehouses with the system that records releases from warehouses (see Chapter 7).

17. The Committee recommends the introduction of a computerised inventory control system, such as TASS, to enable proper inventory control of under-bond goods by Customs. In the case of tobacco products, effective implementation of this system would require declaration to Customs of the quantities of excisable manufactured products and imported products moved into licensed warehouses. Such a system could also monitor all product movements under bond. This recommendation would need to be modified if the point of excise collection were moved as canvassed below.

6.43 As noted earlier, the Committee sought the views of the tobacco industry on the possibility of moving the point of collection of excise duty from entry for home consumption to the point where excise liability is first incurred: that is, when the product is packaged. Changing the point of excise collection to the packaging stage would simplify the administration of excise collection because:

- it is at this point that most Customs controls are currently concentrated;
- opportunities for diversion of product prior to duty assessment and payment would be severely curtailed; and
- Customs would no longer be required to supervise under-bond movement and storage of locally produced tobacco products.

6.44 In attempting to estimate staffing implications resulting from this proposal, it is important to remember that the Committee does not consider that current controls are adequate. It has recommended that better inventory controls be introduced if the present method of collecting excise on tobacco products is maintained. This suggests that estimates of staff cost savings prepared on the basis of current procedures would be increased if the point of comparison were a more rigorous control system than the one currently in existence.

6.45 The Committee recognises that moving the point of excise collection to the point of packaging could cause some initial problems which would need to be addressed when designing the new system. These include:

- an increase in the financial burden carried by industry due to the cost of financing excise-paid stock during storage;
- the handling of returns to manufacturers of stale product on which excise has been paid;
- a system of rebates or credit would be required for the duty paid on product used later for duty-free purposes; and
- the advantage bestowed on imported tobacco products because they can be stored and transported under bond.

6.46 The Committee considers that it should be possible to offset the extra financial costs imposed on industry. For example, payment of excise duty could be deferred for a period or time sufficient to offset the additional cost of financing duty during storage. This could be assessed after obtaining detailed, accurate information on the average dwell time of products under bond. Duty-free sales could be accommodated with the establishment of a credit system. For example, the excise paid on duty-free product could be claimed against the weekly payment or excise.

6.47 To ensure that local product is not disadvantaged by implementation of the proposal, customs duty could be collected on imported manufactured tobacco products after release from the initial warehouse into which goods are entered upon importation. Under-bond transport to further warehouses would not be allowed. This would have the added advantage of freeing Customs officers from supervision of under-bond transfers of imported product.

6.48 The Committee noted with interest industry's proposal that excise could be collected at the factory gate rather than at the point of packaging. However, the Committee believes that such an approach would place the manufacturer with the greatest storage capacity at a considerable advantage over other firms. This may also create an incentive for firms to redefine their factories to incorporate adjacent bond stores. In other words, the Committee considers that the definition of 'factory gate' is not sufficiently clear to ensure consistent treatment of all producers.

6.49 Nor does the Committee accept that implementation of the proposal need financially disadvantage industry: deferral of payment could be organised to offset those additional costs imposed.

6.50 The preceding comments are made essentially from a layperson's understanding of the proposal's consequences. The Committee considers that the area of alternative methods of excise collection should be given more detailed examination. This examination should canvass alternative methods of excise collection, including the proposition that:

- excise duty on manufactured tobacco products be collected at the point of packaging;
- payment of excise duty be deferred for a period of time sufficient to offset the added costs to industry;
- the period of deferral be established by the Departments of Treasury, Finance and Industry and Commerce, in consultation with industry;
- customs duty on imported manufactured tobacco products be collected when the product leaves the warehouse in which it was first stored at the point of entry into Australia; and
- a credit system be established for refund of excise payments on product used for duty-free purposes.

6.51 The Committee recognises that Customs faces considerable difficulties in attempting to prevent excessive speculation prior to the introduction of new excise rates. Although the present system of six-monthly indexation of excise rates should lessen the attractiveness of pre-Budget speculation while the rate of inflation is low, it will not solve the problem. Also, it seems unlikely that the imposition of quota controls could ever be totally effective in preventing speculation. The Committee recognises that Departmental officers must necessarily come into regular, close contact with their clients in order to establish effective working relationships. Existence of close working relationships between clients and Customs officers provides opportunities which may be exploited either intentionally or otherwise.

6.52 The Committee notes that the matter of speculation prior to the imposition of pre-Budget quota controls in June 1983 has finally been referred to the Australian Federal Police for investigation. The Committee did not accept the Department's reasons for not investigating the causes of this matter. The quotas came into effect earlier than ever before. The unusually high clearances of tobacco products and spirits took place on 20 and 21 June 1983 - the two days immediately preceding imposition of the controls.

A full-scale investigation at the time would have shown that Customs places great importance on the maintenance of confidentiality and the integrity of the revenue.

18. The Committee recommends that the Department assess:

- . the cost in officers' time of imposing the controls; and
- . overseas experience of, and possible alternative systems for, prevention of this type of speculation.

19. The Committee recommends that where unusually high clearances of excisable products occur immediately prior to the imposition of quota controls, a detailed investigation of the circumstances be undertaken and the results be reported to the Minister.

6.53 It must be stressed that the Committee has no evidence that information was disclosed prior to the imposition of the controls, other than statements in Parliament. The statistics would suggest that a disclosure had taken place.

6.54 With a view to preventing such an occurrence in the future the Committee considers that the Department should investigate means of reinforcing the requirement that officers act with probity at all times.

CHAPTER 7

BONDED WAREHOUSES

General Background

7.1 Storage of goods under bond provides a means of deferring payment of excise duty on domestically produced goods or customs duty on imported goods, until the commodity is released for home consumption.

7.2 Domestically produced excisable goods can be stored under bond in what is known as an approved place which is a premise approved under s 5A of the Excise Act 1901 for the storage of excisable goods. Imported goods can be stored under bond in a customs warehouse which is a premise licensed under the Customs Act 1901 for the storage of imported goods or for the manufacturing of goods under bond using imported components. Many bonded warehouses have been licensed under the Customs Act for storage of imported goods as well as having approved place status under the Excise Act. There are only a very few approved places which are not also customs warehouses. Warehouses may also obtain permission under reg 92(2) of the Customs Regulations to store duty-paid goods under prescribed conditions. This chapter deals mainly with customs warehouses, although the following short section outlines the procedures used for moving goods into and out of approved places.

Approved Places (excisable goods)

7.3 The control of each of the excisable goods under consideration by this inquiry is discussed in some detail in the chapters devoted to those goods. This chapter sets out the general principles of the storage and movement of excisable goods.

7.4 The Inland Services' General Operations Manual defines an approved place as:

'A place approved in terms of Section 5A of the Excise Act by the Collector, to which excisable goods may be removed and stored under Excise Control without payment of duty or where activities governed by the Excise Legislation may be carried out eg. Vinegar made from Spirits entered for Home Consumption under a security. These may also be licensed warehouses including oil installations.'

7.5 All manufacturers of excisable goods are licensed under s34 of the Excise Act 1901. A license fee is payable and a security is required.

7.6 Excisable goods are not 'entered' into bond as are imported goods. They are moved from the production area or licensed factory, into the approved place, which may be adjacent

to the factory or at an entirely different location often in a different State. These movements take place under Customs permission; either continuing permission or single transaction permission (see next section). Most major producers of excisable goods operate under continuing permissions. A continuing permission holder is required to maintain normal commercial documentation showing all movements of goods under that permission. While no returns covering these movements are furnished to Customs they do have access, for checking purposes, to the commercial documentation.

7.7 Excise becomes payable when the commodity is released from bond and entered for home consumption, by means of a Nature 40 entry.

Customs Warehouses (imported goods)

7.8 Customs warehouses are essentially secure premises which have been licensed to allow a range of permitted activities under bond. A warehouse license specifies the type of use to which a particular warehouse may be put. On this basis, the following types of warehouses can be identified:

- general warehouses for warehousing goods generally;
- private warehouses for warehousing goods which are the property of the licensee;
- machinery warehouses for warehousing of machinery and similar heavy or building goods;
- manufacturing warehouses for warehousing goods for use under prescribed conditions, in a warehouse used in any manufactured goods trade or process; and
- transit warehouses for the temporary warehousing of goods.

7.9 In January 1984 there were approximately 1,400 licensed premises in Australia and of these over 1,100 were customs warehouses as opposed to approved places. A breakdown of the various types of licensed premises is given in Table 7.1.

7.10 In 1982/83 customs duty paid on goods released from bond in Australia was approximately \$600 million and as a rough guide, the value of goods in bond over that period was approximately three or four times that amount.

7.11 Licensees must pay an annual licence fee and a fee for each entry. A security is also required. At March 1984 annual licence fees for customs warehouses were \$1,900 and \$7 for each entry.

TABLE 7.1 NUMBER OF CONTROLLED PREMISES (At 27 March 1984)

	NSW	VIC	QLD	WA	SA	TAS	NT	ACT	TOTAL
A	5	6	4	1	2	2	1		21
B	2	2	2						6
C	15	11	3	1	16	2			48
D	90		31	3	2				126
E	14	5	4	1	16				40
F	4	4		2					10
G	4	6			9				19
Ha	29	29	35	24	13	11	13		154
Hb	47	16	21	18	6	2	4	2	116
Hc	<u>297</u>	<u>236</u>	<u>108</u>	<u>111</u>	<u>66</u>	<u>22</u>	<u>10</u>	<u>4</u>	<u>854</u>
H	373	281	164	153	85	35	27	6	1124
TOTAL	507	315	208	161	128	41	28	6	1394

A	Breweries	H	Customs Warehouses -
B	Tobacco Factories	a	Petroleum
C	Liqueur Manufacturers	b	Duty Free Shops
D	Coal Mines	c	Other
E	General Distillers		
F	Vigneron Distillers		
G	Wine Distillers		

Note: The above figures, particularly those relating to warehouses, are subject to change.

7.12 Licensees of bonded warehouses are required to ensure that the goods under their control are physically secure and that all movements and transactions involving these goods are properly documented. Specified details of the transactions which formally enter goods into bond are declared to Customs. Similarly, details of all transactions removing goods from bond, into home consumption are also declared. The declarations are made on forms known as Nature 20 and Nature 30 entries. Nature 20 entries are used for documenting the entry of imported goods into bond. Nature 30 entries are used for releasing imported goods from bond into home consumption. The entry and release information for imported goods is recorded separately on separate parts of the Customs computer system.

7.13 Movement of under-bond goods from one warehouse to another requires Customs approval. This is either obtained separately for each transaction or through use of the 'continuing permission' facility whereby approval is given to some licensees to transfer under-bond goods without notifying Customs beforehand. Licensees who are granted 'continuing permissions' are required to keep documentation on all transfers of goods made under this arrangement. This information is not submitted to Customs but is available for inspection by Customs officers. Details of under-bond transfers are not held by Customs.

7.14 The Auditor-General's Efficiency Audit Report describes the operation in the following words:

'Bond stores operations are simple 'in-hold-out' operations wherein goods remain untouched during storage and the recording or movements is a basically simple inventory recording system. The potential duty is known once the goods are declared on entry into Australia. However, goods may be received under-bond on single transaction permissions or continuing permissions which are not recorded through ADP facilities.'

Since the details of transfers of under-bond goods are not entered into the Customs ADP system, and entry and release data is kept separately, it appears that Customs is not in a position to establish, independently, what stocks should be in any warehouse at any point in time or to identify easily the length of time goods stay under bond (ie dwell times).

7.15 Under the 'commodity control' system, the owner declares the dutiable value of goods when entering them into bond and again when entering them for home consumption. Customs officers perform documentary checks of records kept by warehouse licensees as well as physical checks of goods held in a warehouse, and goods being entered into bond or being moved. These checks are designed to ensure that the documentation covering these transactions is accurate. The documentary checks matching entry information held on the Customs ADP system with warehouse licensee records, cover 100% of entries. The same holds for releases from bond. Physical checks are only carried out on a

sample of transactions or goods. When goods are released from bond for home consumption, Customs officers also retrieve the data on the original entry of those goods into bond, and check that the description of the goods and the declared dutiable value is the same as that declared on the entry into home consumption.

7.16 Customs also carry out assessments of the performance of warehouses and since licenses must be renewed annually this provides a direct means of control over licensees.

7.17 According to information provided by Customs (Table 7.2) only 43 man-years were devoted to warehousing throughout the whole of Australia in the 18 months from January 1982 to June 1983. These resources had to cover over 1,100 warehouses. Six months may elapse¹ between Customs' visits to a particular warehouse.

TABLE 7.2 CUSTOMS MAN-YEARS DEVOTED TO WAREHOUSES (Jan 1982 - June 1983)

TOTAL	NSW	VIC	QLD	SA	WA	TAS	NT	
1982	14.31	5.55	3.58	1.82	4.08	0.39	0.02	29.75
Jan-June 1983	6.43	2.64	1.19	1.44	1.46	0.43	N/A	13.59
TOTALS	20.74	8.19	4.77	3.26	5.54	0.82	0.02	43.34

Source: Australian Customs Service

7.18 A computer based system for the control and accounting of all goods under Customs control has been developed conceptually by Customs. The system known as Total Accounting Base System (TABS) is designed to provide automatic reconciliation of bond entries and releases and to register all permission holders. A feasibility study on such a system has been carried out by Customs. That study recommended computer reconciliation of goods entered for warehousing on Nature 20 entries and goods cleared from bond on a Nature 30 entries. Such reconciliation was seen by the TABS study as the first stage of an overall inventory control system. The system has not been implemented.

7.19 In South Australia, computerisation of all under-bond spirits movements was tested on a pilot basis. The system known as GROGLOSS, was discontinued after discussions at the 1982 Collectors Conference, where it was decided that the system was not suitable for implementation nationally.

1 In Camera Evidence, 29 March 1984.

Findings of the Auditor-General's Efficiency Audit Report and the Departmental Response

7.20 Audit's findings, as reported in the Efficiency Audit Report, suggested that control over revenue collection from bond stores could be improved by:

- tightening control over continuing permissions including regular review of continuing permission holders;
- merging the present ADP systems for entries into bond and releases from bond, to give an overall inventory control system for documented goods;
- a more discriminatory approach in documentary and physical checking towards stores attracting higher revenue, and recognising risk factors;
- introducing systems to identify goods for which records suggest particularly long dwell times, indicating potential risk to revenue. (Very long dwell times may suggest the possibility that the goods have been removed without notification and appropriate checks could then be made on these goods);
- monitoring the cost-effectiveness of Customs' operations in the warehousing area to assess the level of control resources required.

7.21 The Department of Industry and Commerce's responses to these findings are summarised below. These summaries attempt to assimilate all of the material provided by the Department over the period of the inquiry.

7.22 **Controls over continuing permissions**
The Department's first submission to the Committee in May 1982¹ indicated that 'A Nationwide listing of all Continuing Permissions is in stages of preparation and this listing will be computerised'. However, in the Department's submission of August 1983² this progress appeared to have been reversed. The August submission indicated that the Total Accounting Base System (TABS) Feasibility Study had recommended that 'consideration be given to the development of a national profile system which provides total detail of all continuing permission holders, permission details and their performance record.' The implementation of the TABS proposal however, was postponed (for consideration after the beginning of 1985) by the Department's ADP Steering Committee, due to competing demands on ADP resources. At the same time the Department reported the setting up of a working party to 'conduct a comprehensive review of cargo control procedures including the under-bond movement of cargo'. The working party was to give priority to undocumented cargo.

1 Minutes of Evidence, op. cit., p. 35.

2 ibid., p. 397.

7.23 In June 1983 and February 1984 the Department made submissions to the Committee concerning the Auditor-General's comments on cargo control contained in his September 1982 Report. In January 1984 the Committee also received the Department's response to the Auditor-General's September 1983 comments on warehousing (see next section). These submissions confirm that priority has been given to control of undocumented cargo rather than movement of under-bond goods. In this context the Department reported that some trials had been conducted on the use of a computerised 'Permissions Profile System' and full computerisation of 'interport movements of cargo from Victoria to South Australia and Tasmania' with a view to introduction on a national basis early in 1984/85. Priority is being given to introducing this system for movement of undocumented cargo before its introduction for documented cargo (ie warehoused goods).

7.24 The submissions on cargo control indicate that the development of the TABS concept has been extended to what is now known as an 'integrated cargo control and clearance system'. The original TABS proposal was purely an accounting system for cargo. The new system is intended to 'integrate the accounting and clearance systems and to use current cargo status information to direct the employment of cargo control resources. As at February 1984, however, Customs was still seeking Departmental commitment to such a system and agreement on the main elements.

7.25 **Reconciliation of bond entries and releases**
The merging of the ADP systems which maintain details of entries to and releases from bond, to allow a reconciliation of these data, was also part of the TABS proposal and this recommendation has therefore suffered the same fate as the proposed computerisation of permissions (described above). Presumably the 'integrated cargo control and clearance system' would incorporate such reconciliation, but the intended timing for introduction is not at all clear under the reported recent developments.

7.26 **Attention to areas of higher yield**
Audit found that Inland Services in NSW, was able to produce from its ADP system, the value of duty generated by each licensed warehouse. An analysis by Audit led to the conclusion that in NSW 97% of revenue was generated by 42% of the warehouses but resources did not seem to be directed accordingly. In its submissions to the Committee, Customs has given no indication whether this recommendation has been specifically addressed. In the broader context, work is proceeding on the development and introduction of risk management procedures into State operations but this development is clearly taking some time. The cursory analysis that Audit performed would seem to provide a good indicator, in the meantime, as to where resources could be most effectively deployed.

7.27

Dwell times

Customs has indicated that the length of time goods stay under bond (ie dwell time) can be extracted from their documentation but it appears that this can only be done manually. In its February 1984 submission on cargo control Customs states:

'As performing the matching function by manual methods is extremely labour intensive this type of exercise cannot be sustained.'

7.28

This suggests that dwell times could realistically only be determined for individual batches of goods selected at random. The Committee, however, interprets the Auditor-General's comments as recommending a comprehensive analysis of dwell times for all goods in warehouses so that this factor can be used in the risk assessment process to determine where investigative resources should best be deployed at any particular time.

7.29

Monitoring cost effectiveness

A pilot survey designed to test the effectiveness of Customs warehousing operations was concluded in April 1982. The report on that survey was entitled 'Random Survey of Warehouse Operations'. This sample survey gave an indication of dwell times of goods under bond, the types of 'errors' picked up, their incidence and their significance to revenue. When questioned about the uses to which the results of this survey might be put the Department responded¹ that the report was not given very high status because of deficiencies in the methodology and that further work in the area was postponed while efforts were concentrated on risk management.

Comments from the Auditor-General's September 1983 Report and the Departmental Response

7.30

In his September 1983 Report the Auditor-General reported deficiencies in Customs warehousing operations in the following areas:

- procedures for collection of fees in Western Australia and New South Wales were found to be deficient in some aspects;
- in New South Wales assessment reports on the performance of warehouses were, in some cases, not being placed on licensing files prior to renewal of licenses;
- fees were being charged on a basis that was not consistent with the Department's cost recovery policy;
- security checks were not being carried out on prospective licensees in Queensland and Western Australia;

1 In Camera Evidence, 29 March 1984.

- deficiencies in the risk assessment procedures used to plan inspections of warehouses were identified;
- file records of inspection work and assessments of warehouse performance were lacking;
- the Department's program for inspection of warehouses was in arrears in New South Wales and Western Australia;
- the requirements of Customs Regulations in respect of the storage of duty-paid and duty-free goods in warehouses were not being met in New South Wales in all cases;
- training of investigation officers in Western Australia appeared to be inadequate;
- internal audit coverage was inadequate in Western Australia and Queensland;
- an anomaly existed between the Act and Customs Regulations;
- the Department's internal check program designed to ensure compliance with legislation and policy was in arrears and deficient in New South Wales and Western Australia; and
- deficiencies were found in controls over access and entries to computer records.

The Auditor-General's September 1983 Report also asked the Department's Central Office about alternative methods of recording under-bond movements. The main concern in this area was described as follows:

The present system of movement of under-bond goods relies on the maintenance of proper records by warehouses and default in this regard presents the Department with difficulties in establishing the duty liability upon the release of goods for home consumption.

7.31 In response to a request from the Committee the Department provided a submission covering the above matters. This submission is reproduced at Appendix 3. The Committee is generally satisfied with the action being taken by the Department to correct the problems highlighted in the Auditor-General's Report. In several of these areas corrective action was anticipated but was still outstanding at the time of preparation of this submission. These areas included:

Review of fees

In December 1983 Public Service Board approval was obtained for the engagement of a consultant to review the basis for setting fees and the possibility of full recovery of costs incurred in the control and maintenance of the licensed warehouse system.

Risk assessment

The Department is developing and implementing risk management on a national basis.

Training

A standardised training course has been developed and is being used nationally. The course includes elements of investigation training and risk management. In 1984 six further Inland Revenue specialist courses have been scheduled.

Internal audit

The Department's 1983/84 Internal Audit Plan is to cover warehousing in New South Wales, Victoria and South Australia.

Computerisation of under-bond movements

A program has been developed and tested and is now being refined, for the computerisation of movements of undocumented cargo interstate. This system is eventually to be extended to cover documented cargo. The submission states that the Department has accorded a high priority to the development of this system.

Alternatives to the Bonded Warehouse System

7.32 The Committee recognises that by considering alternatives to the bonded warehouse system it is moving into what could be seen as a policy matter. Nevertheless the Committee does wish to make some comments on this issue.

7.33 When considering possible alternatives it is first necessary to identify what the existing system is achieving. The storage of duty un-paid goods under bond can be seen simply as a credit facility. The Committee recognises the strength of the argument that such a credit facility is of great importance to the viability of operators who might otherwise have to pay large sums of duty quite some time before being able to recoup this cost through sales. However, the Committee would like more thought to be given to alternative, more efficient ways of providing such a credit facility.

7.34 It appears that the bonded warehouse system was originally developed primarily to allow longterm maturation of spirits and to house unclaimed (or 'time-up') cargo. Bonding is now used far more extensively to defer customs duties on a wide range of imported goods. The pilot survey, completed by Customs in April 1982 into the effectiveness of their warehousing operations, suggested tentatively that the average dwell time under bond for most goods is only 2-3 months. (It should be noted that Customs is not confident of the reliability of this survey.) Although these figures should be treated with caution, it appears that the system may be merely extending the credit terms for many importers by several months. Presumably this can be done in other ways, which, if necessary, could maintain the current levels of financial assistance while reducing control problems associated with storage of goods in bond. The Committee is aware that maturing spirits require much longer storage periods than the other commodities and therefore the area needs to be treated as a special case.

7.35 The Committee acknowledges that the manpower resources devoted by Customs, to the supervision of the bonded warehouse system (see Table 7.2) may not seem very great. Therefore the potential savings may appear insufficient to warrant substantial changes. The Committee however, is uncertain about the effectiveness of the system and is therefore concerned about the possibility of excise being avoided.

7.36 The possibility of replacing the bonded warehousing system with duty credit arrangements was proposed at the 1971 Collectors' Conference. The proposal was not taken up.

7.37 During this inquiry the Committee sought a paper from the Department on possible alternative systems and their implications. This paper is reproduced at Appendix 4. The paper provides a broad starting point for a detailed analysis of alternatives and their feasibilities and the Committee considers that the paper should be used in this way.

7.38 Options examined briefly in this paper include:

- a credit system (as in the UK or Denmark);
- a reduction in the number of warehouses by abolition of private warehouses (all goods to be stored in general or public warehouses);
- immediate entry of goods into home consumption;
- payment at sale of goods by means of a wholesale tax or sales tax.

7.39 The paper, however, does not identify the alternative which in the Committee's view, could prove to be the simplest. This simple alternative involves the abolition of the bonded warehousing system together with a downward duty rate adjustment to compensate for the cost of the credit required to pay the duty earlier. The adjustment may need to be different for different goods according to their average dwell times under bond. The Committee considers that it could be possible through research effort and discussions with industry to identify these average costs and therefore the necessary duty adjustments. The Committee would like to see detailed consideration of this option as well as the other possibilities identified.

Industry Response

7.40 In September 1983 the Committee placed an advertisement in the major daily newspapers calling for public submissions to assist the Committee in this inquiry. As a result of the advertisement the Committee's Secretariat answered telephone queries from people interested in the inquiry and those who wanted to make submissions. The Committee notes with interest that the greatest proportion of calls were from people concerned about the effect of the inquiry on bonded warehousing. This topic, however, did not elicit many written submissions.

7.41 The New South Wales Road Transport Association made a submission to the Committee defending the existing system. The Association argued that if the present bonding arrangements were abolished

'There would be cash flow problems and difficulties in borrowing arrangements which could have a direct effect on the viability of companies involved in the import/export industry.'

7.42 The spirits industry also offered some views on bonded warehouses in their submissions. In particular, the Distilled Spirits Industry Council argued that the per entry fees for bonds should be abolished and Bundaberg Sugar argued that the continuation of the bond system is vital to firms' survival in the spirits industry.

The Committee's Comments and Recommendations

7.43 The Committee's investigation of the bond system highlighted a feature of current arrangements which is worthy of comment. The Committee found that domestically produced excisable goods are not 'entered' into bond as are imported goods. They may be moved from the production area or licensed factory into the so called 'approved place' which may be geographically quite distant. The Committee realises that such movements take place under Customs permission and that a condition of such permission is that Customs has access to the company's documentation.

20. The Committee recommends that there be a formal "entry into bond" for domestically produced excisable goods with documentation and control comparable to that exercised over imported goods under bond.

7.44 The Committee is concerned that Customs does not, at any time, have sufficient information to be able to determine exactly what stocks should be in a particular warehouse. This arises because there is no regular or automatic balancing of entry and release information by Customs and because additional goods can be moved in under continuing permission without Customs being informed. In any case Customs apparently rarely performs its own independent stocktakes and generally seems to limit physical checks to only a sample of goods and some supervision of the company's own stocktake. Customs' visits to some warehouses may only take place at six month intervals. In these circumstances it would appear that goods could be moved into and out of bond without formal entries or releases being made and they would not necessarily be detected. Another possibility would be that goods are moved out of bond and documentation only submitted much later so as to gain further deferral of duty payment. The only deterrent appears to be the possibility of a random line check on a particular item and the probability of this occurring may not appear very great to the operator.

7.45 While the Committee did not find evidence of such practices it does consider that the system should be designed more tightly to eliminate the possibilities. The suggestion made by the Australian Associated Brewers (AAB) to improve control over under-bond storage and under-bond movement of excisable product is highly relevant here. The AAB advanced the proposition that computer facilities be developed and adapted to permit producers to advise Customs of each under-bond movement. The Committee sees considerable merit in a measure such as this, particularly in view of the commercial support it reputedly enjoys.

7.46 It must be realised, however, that such a system of computer-based monitoring would take some time, perhaps several years, to apply. This timing factor underscores the necessity for a comprehensive array of tools which can be applied to improve the current excise collection system. The Committee considers that it would be inappropriate to rely exclusively on one possible innovation although it may be quite laudable in its own right.

21. The Committee considers that the Department's control procedures for bonded warehouses lack sophistication and that better use could be made of ADP facilities in this area. The Committee recommends that immediate attention be given to upgrading control systems for bonded warehouses.

22. The Committee recommends that Customs promptly develop and implement a computer system which reconciles bond entries and releases so as to provide sufficient information to allow proper inventory control in bonded warehouses.

This should lead to the computerisation of all under-bond movements so that as goods are despatched from one bond their intended destination is entered into the system which automatically checks whether their arrival at that destination is entered within an appropriate interval of time.

23. The Committee endorses the Auditor-General's recommendations that Customs should analyse dwell times of goods under bond and direct investigative efforts to those goods with apparently lengthy dwell times. Similar comments apply to Audit's suggestion that efforts should be concentrated towards those warehouses which yield the greatest revenue.

7.47 Another matter of considerable concern to the Committee is the fact that no sensible use appears to have been made of the cost effectiveness survey of warehousing operations (concluded by Customs in April 1982). The Committee accepts that Customs may wish to treat the specific results of this survey with care because of claimed deficiencies in the methodology. Nevertheless there appears to be some useful information in the report. For example, types of 'errors' detected are identified and this information could be used to try to redesign parts of the system to tighten up control over these areas. Also, this survey or a similar one, with the methodology better developed, may be useful in estimating overall revenue loss due to undetected errors. The Committee considers this an extremely important area because it provides an indication of the costs to revenue involved in the operation and would permit a much better basis for determining appropriate resource allocation for warehouse controls.

7.48 At the very least, the report on this survey gives an indication of the potential benefits to be had from such effectiveness measurement exercises. It should therefore prompt further work to iron out the methodological problems so that further surveys can be carried out and some use can be made of the data.

24. The Committee recommends that Customs examine the benefits to be gained from effectiveness surveys, correct the methodological problems experienced with the warehousing survey and proceed with further surveys as soon as possible so the results can be used as management aids.

25. The Committee also recommends that the perceived need for the bonded warehouse system should be re-examined, including the implications of abolishing or modifying the system. The Committee considers that this issue should be referred to the Industries Assistance Commission (IAC) for inquiry.

CHAPTER 8

PETROLEUM PRODUCTS

General Background

8.1 Customs and excise duties are levied on the principal petroleum products. As from 21 August 1984 the rates of excise duties were as follows:

	cents/litre
. motor spirit	9.397
. aviation gasoline (avgas)	7.91
. aviation turbine kerosene (avtur)	7.514
. automotive diesel oil	9.397
. industrial diesel fuel	9.397
. marine diesel fuel	9.397
. fuel oil, heating oil, power kerosene and lighting kerosene	1.949

8.2 In 1983/84 \$1,973 million was collected from excise levied on petroleum products. The estimated revenue for 1984/85 is \$2,151 million.

8.3 In June 1984 there were six major oil companies operating in Australia. Ten oil refineries located around Australia's seaboard account for most of our refining capacity. Two of these however, are scheduled to close in the near future. Generally, the refineries process both imported and locally produced crude oil and produce a range of petroleum products.

8.4 Approximately 30% of petroleum used in Australia is met from imports. These imports however, are predominantly in the form of crude oil rather than refined petroleum products. We import only about 10% as refined products. The proportion of motor spirit imported is negligible and is generally limited to supplies from Singapore for some areas in the north-west of Australia.

8.5 Refineries are licensed by Customs to allow manufacture of excisable products. The licensee is required to submit to Customs detailed plans of the physical layout of the plant including discharge pipelines. From refineries petroleum products are transferred under bond to bulk storage depots. This is usually done either by pipeline direct to the depot or by pipeline to barges or coastal tankers for delivery to depots at other locations around the coast. Transfers may also take place by rail tank car and road tankers. Tank level readings at the refinery are taken before and after each discharge.

8.6 The storage depots are effectively Customs warehouses and are therefore licensed to receive imported petroleum products (liable for customs duties) as well as having 'approved place' status so that they can be used for storing locally produced excisable petroleum products. Customs refer to such depots as licensed petroleum installations. At March 1984 there were 156 licensed petroleum installations around Australia, most of them on the coast.

8.7 Significant quantities of crude oil and refined products are transferred between oil companies under 'borrow and loan' arrangements. These arrangements have been developed to achieve an efficient distribution of the full range of products, through a limited distribution infrastructure, to a market which is spatially very widely dispersed. This means that the transfers of product from refineries and installations are not always to consumers or to the operating companies' depots but are often made to other companies' storage depots.

8.8 Excise is levied at the point of release of petroleum products from the licensed petroleum installations. Weekly settlement applies and the company operating the installation pays rather than the company receiving the product.

8.9 From the installation, product is usually released into road tankers, rail tank cars or drums. Releases into road tankers are measured by means of flow meters which in some Collectorates are regularly calibrated and checked by Weights and Measures officers. Full delivery details are shown on the load docket which is issued for each road tanker delivery. Operators are required to prepare daily listings of all load dockets for petroleum products. Releases into rail tank cars are measured by dipping compartments. The total amount of product filled into drums is determined by 'before and after dips' of bulk storage tanks.

8.10 Records of all releases of petroleum products from the installation are tallied at the end of the week and usually forwarded to the State office of the company. On the working day following the last day included in the tally, the company submits an entry for home consumption and pays the duty. The State Collectorate sends a copy of the entry and payment details to the Sub-Collector in whose area the installation is located.

8.11 Refineries are required to submit returns to Customs regularly, indicating actual production of all the finished, marketable products which are subject to excise. Production statements cover refinery production as well as details of crude oil supplies to the refinery and all releases from the refinery including movement records for each delivery pipeline.

8.12 Similarly, operators of licensed installations are required to submit a 'Statement of Operations' covering receipts, releases, stocks and losses for all finished products under Customs control in the installation. Determination of the frequency and format of the Statement of Operations is left to the discretion of the Collector concerned.

8.13 Customs controls over excisable petroleum products are based on the 'commodity control' principle. Under these arrangements the operator of the licensed installation is required to measure the quantity of dutiable goods being released into home consumption and to calculate the amount of duty payable. At the time of licensing the premises Customs specify which records the licensee is to maintain and produce upon request to assist in the validation of revenue payments.

8.14 Under commodity control Customs essentially relies on the company's own control systems for protection of the revenue. The petroleum refining and distributing companies have controls over movement of a product at every stage. The Auditor-General's Efficiency Audit Report¹ lists these stages as:

- . production controls;
- . transfer controls;
- . inventory controls;
- . loading controls;
- . administrative controls; and
- . measurement controls;

Customs officers perform documentary checks on entries for home consumption, physical checks of inventories held and documentary checks of firm's records for internal consistency.

8.15 Losses of product prior to entry for home consumption must be accounted for and explained to the satisfaction of the Collector. This is done for each or four stages in the refining and distribution process:

- . within the refinery;
- . refinery despatch to installation receipt;
- . losses on tankship transfers; and
- . losses within installations.

Acceptance or rejection of the explanation for a loss is generally based on an analysis of the historical pattern of losses at the installation concerned.

8.16 Customs has advised that in 1982/83 total losses for motor spirit throughout Australia for each of the last three stages listed above, were approximately as follows:

- . ex refineries into licensed installations: 0.03% gain;
- . tankship transfers from refineries to licensed installations: 0.32% loss; and

1 The Efficiency Audit Report, op. cit., p. 59-61.

- ex licensed installations into home consumption:
0.04% loss.

Auditor-General's Comments

8.17 Audit's main concern in the petroleum area was that Customs had no independent check of total duty liability because they had no way of estimating total production. Furthermore, at the time of the Efficiency Audit, Customs did not as a matter of course, even use the production data supplied by refineries to reconcile total declared production against duty paid. In the words of the Efficiency Audit Report:¹

'There is an implicit assumption in Inland Services' present approach that all the product flows down the line through the measurement process, with no diversion of product prior to measurement. However, investigations are not carried out to justify this assumption.'

8.18 Another matter of concern to Audit was the way in which losses were handled by Customs. Audit felt that losses were too readily accepted, without significant technical validation or investigation. In particular Audit was concerned that:

- losses were not monitored for all refineries and checks were not performed to assess the accuracy of loss figures declared;
- no reconciliation had been performed by Customs to ascertain whether losses reported by companies during transfer between refineries and depots were excessive;
- losses within depots were not assessed technically but generally accepted; and
- meters for the measurement of product leaving depots were not being checked regularly in all Collectorates and meter proving was rarely supervised or monitored by Customs.

8.19 Audit also claimed that there was no investigation of refinery layout, by the Department, to establish the potential for diversion of product prior to excise payment.

8.20 -- The Efficiency Audit Report² recommended that:

- '(i) Inland Services should require secure metering of production volumes and should examine production and distribution facilities to ensure total coverage of production.

¹ The Efficiency Audit Report, op. cit., p. 62.

² *ibid.*, p. 12.

- (ii) On a sample basis, Inland Services should undertake reconciliation checks of refinery and depot transfer volumes.
- (iii) More detailed assessments of company claims for losses should be made. This will require Inland Services to acquire additional technical skills.
- (iv) Given the complexity of the refining industry, Audit recommends that detailed consideration be given to introducing measurement of total production immediately the product assumes the characteristics of petroleum. The burden of proof for losses should then be with the producers, but Inland Services would use a technical capability to validate loss claims. The Department should initiate discussions with oil companies, assisted by independent expertise in flow measurement of the kind required in complex processes, with a view to examining the cost/benefit and technical implications of installing accurate flow measurement devices immediately downstream of dutiable commodity production. As part of these considerations, it should also review the technical skills it would need to facilitate its assessment of company claims for losses. The investigative strategy would be reoriented toward technical assurance of the production accounting system and away from clerical confirmation of the internal consistency of returns.'

Departmental Response to the Efficiency Audit Report

8.21 The feasibility of introducing sealed meters at refineries was considered by a team from the Department's Management Advisory Section. Before reporting, in July 1982, the team obtained support for its conclusions from the petroleum industry. The report rejected the use of sealed meters for a range of reasons, the main one being the high cost of their installation. The team judged that a single meter was insufficient and that a metering system was required. A metering system was estimated to cost \$750,000 for each product line.¹

8.22 At the time of the Efficiency Audit it was not standard practice for Customs to design its checks to ensure that all refinery production was accounted for. However, since the Efficiency Audit Report was tabled, Customs has been carrying out a series of reconciliation checks on transfers between refineries and depots. At the public hearing on 7 May 1984 Customs informed the Committee that Central Office had received results of reconciliation exercises from all States. These involved checks

¹ Minutes of Evidence, op. cit., p. 380.

of quantities despatched from refineries against quantities received into installations. This reconciliation process is now an ongoing part of the Customs operation and the results for 1982/83 showed a slight overall gain in quantities. In Queensland, Customs is using a computer for this work.

8.23 The Committee concludes that while the Department accepted Audit's recommendation suggesting more detailed assessments of claims for losses, the Department seems to have been slow to respond with action in this area.

8.24 The Department has indicated that there would be difficulties measuring production and/or levying duty 'immediately the product assumes the characteristics of petroleum' as suggested by the Auditor-General. It was argued that further blending of components to achieve finished product specifications usually takes place beyond this point. Furthermore, some product is used as refinery fuel or as feedstock for an associated petro-chemical plant and is therefore not dutiable. However, when questioned about the possibility of levying excise at the point of release of motor spirit from the refinery (a point at which companies already keep very careful and detailed account of releases) Departmental officers indicated that there were advantages in this approach and that it would be possible to implement. It was suggested to the Committee that levying duty at the refineries would make duty collection on the major products such as motor spirit and distillate much easier but that there would be some difficulties with products such as avtur because of the high proportion of duty-free usage. The possibility of problems arising over ownership of the product and liability for excise, where crude oil is refined for another company, ('toll' refining) was also raised.

Industry Response

8.25 During the course of the inquiry the Committee visited the Ampol refinery at Lytton in Brisbane, a Mobil installation in Bundaberg, the Caltex refinery at Kurnell and terminal at Banksmeadow. These visits allowed the Committee to become more familiar with technical aspects of refining and distribution of petroleum products and to canvass the views of the industry on an informal basis.

8.26 The Committee was particularly impressed with the sophistication of Caltex's metering system at their Banksmeadow terminal in Sydney. This system is outlined in material at Appendix 5. The system, complete with associated automatic data recording and processing facilities cost the company several million dollars to install. The system measures, records and accounts for all product releases from Kurnell which pass through Banksmeadow.

8.27 Written submissions were also sought from the industry. In response the Committee received submissions from:

- . Ampol Limited
- . BP Australia Limited
- . Shell Company of Australia
- . Amoco Australia Limited
- . Mobil Oil Australia Limited
- . Caltex Oil (Australia) Pty Ltd
- . Esso Australia Limited, and
- . The Australian Institute of Petroleum Limited.

8.28 All submissions expressed the same concerns about the practicability and the high costs of installing meters to measure production, the costs of maintaining this equipment, the increase in working capital required if excise duty were payable at the point of production and the difficulties for the companies in accounting for losses, and getting rebates for these losses, after the duty has been paid.

8.29 All expressed confidence in the current system of measurement and in the continual efforts made by the companies to improve the measurement of petroleum production and movements.

8.30 The Auditor-General's Efficiency Audit Report recommended the introduction of 'secure metering of production volumes'. This recommendation provoked a negative response in all submissions. Complaints were based on the high costs of installation, maintenance and upgrading the companies' own measuring equipment to the same standard.

8.31 Most companies felt that the Efficiency Audit Report had seriously underestimated the cost and number of meters required. The total cost of flow measuring devices depends on pipeline diameters, flow rates, operating pressures and types of product transferred. The Australian Institute of Petroleum suggested that not only are meters required but also piping, valves, proving equipment, electricians and a complete electronic read-out system. Caltex estimated the cost of metering within the Caltex refinery to be \$3-5 million with an annual maintenance cost of 2-3% of the investment cost. Caltex felt that an investment of this size was not justified considering that the Efficiency Audit Report estimated a potential revenue gain of only \$10 million. Mobil expressed doubt that this estimate of the excise shortfall was still relevant due to lack of comparison between time periods and since procedures for excise exemptions for off road distillate use had changed significantly since the Report was written.

8.32 Ampol expressed the view that absolute accuracy in the measurement of petroleum products was impossible to achieve given current measurement technology. Transit, evaporation and other losses cannot be accurately and continuously measured.

8.33 The view of the oil industry appears to be that the current system of measurement by dipping provides the necessary level of accuracy and control. There has been a steady improvement in this system particularly in the extent and sophistication of automatic dipping and with computerised metering equipment installed in larger throughput terminals.

8.34 All companies expressed the view that in the area of measurement, the Government's and the companies' interests coincide. In fact all brought to the Committee's notice the fact that the value of any losses to the Company from theft, evaporation or manufacturing losses, was several times the value of the Government's loss of excise revenue.

8.35 The view was generally expressed that due to the current low levels of industry profitability, any additional costs to the industry would either be passed on to the consumer or would be reflected in a decrease in capital spent by the industry in improving capital efficiency.

8.36 The Efficiency Audit Report's recommendation to introduce 'measurement of total production immediately the product assumes the characteristics of petroleum' also produced a critical response in all submissions. Although the principal argument against this recommendation centered on the cost due to prolonging the period between the payment of excise duty and its recovery from consumers, some submissions were also concerned with definitional aspects of duty payable under the Excise Act.

8.37 BP did not see petroleum products as having the characteristics of excisable products until distribution had occurred. Until this point, the products were considered as components suitable for blending. Caltex confirmed this by stating that some product on which duty would have to be paid, may never leave the refinery gates as a result of product interfacing, sludge at tank bottoms etc. Also, some of the product transferred to coastal ships for intra-state and interstate transport may not reach its destination. Some residue remains which, together with the sludge and contaminated products mentioned above, is rerefined and would therefore face double duty.

8.38 AMPOL stated that any product losses occurring prior to entry for home consumption are not relevant to the calculation of duty payable under the Excise Act 1901, unless product is illegally diverted and then used for home consumption. The further point was made that oil companies already have a strong monetary incentive to reduce these product losses.

8.39 All companies were critical of the increased working capital burden that would result from imposing excise duty at an earlier point in the production process. Excise is collected on a seven day basis but the oil companies operate in an industry with 35-45 day credit terms. This gap already imposes a significant

working capital burden on the industry. For example under the present system Mobil's unrecouped excise payments average \$27 million. At an interest rate of 14%, the overall annual cost to Mobil of financing this amount is \$3.8 million. Moving the point of collection to an earlier point would increase unrecouped excise payments to \$59 million. Other companies submitted similar statistics.

8.40 BP expressed the view that earlier collection should be compensated for by delayed payment terms or increased sale prices. Mobil suggested the Government extend credit for 30 days for every month except July, to relieve the companies of the costs of Government revenue raising.

8.41 Caltex suggested that full recognition should be made of unavoidable and genuine losses. If the point of measurement for duty were moved to the point of production then excise would be incurred on handling and evaporation losses on stock provided under refinery exchanges to other industry members and on sales to international bunkers and Commonwealth departments and instrumentalities. This would generate many claims for rebates. Most companies reiterated this view and commented on the expense that would be incurred in documentation and verification of these losses with Customs officials.

8.42 Mobil and Amoco both expressed the view that earlier collection of excise would be a disincentive to hold adequate inventories of finished product. Consumers would thus be more vulnerable to supply disruptions.

8.43 Towards the end of the inquiry the Committee approached all oil companies for a reaction to the specific proposal to shift the point of excise collection back to the refinery gate. All companies rejected this proposal reiterating the points against earlier collection outlined above. The main arguments against the proposal centred on the cost of financing increased working capital and the need to make allowance for losses beyond the refinery gate.

The Committee's Comments and Recommendations

8.44 Committee wishes to stress at this point, that in examining excise collection procedures its intention is to try to identify more efficient ways of achieving basically the same, or a very similar result, to that which is achieved under the existing arrangements. Consequently, the Committee is concerned that companies should be compensated for any disadvantages which may result from adjustments made to the collection procedures. In other words, while the Committee is concerned with the efficiency and effectiveness of collection procedures it is not concerned with policy matters such as altering the overall level of financial advantage or disadvantage incurred by operators. Such policy matters are properly the concern of Government rather than the Public Accounts Committee.

8.45 The Committee's examination of the petroleum area suggests that there may be advantages in redesigning the collection procedures for petroleum products so that excise liability is assessed and excise is levied at the point at which product is released from each refinery. Some of the advantages of this approach are suggested in the following paragraphs.

8.46 As outlined earlier in this chapter, oil companies generally release products from their refineries to a range of other companies as well as their own depots. Consequently for their own commercial purposes refining companies need accurate measurements of releases of all products from refineries and detailed and accurate records of these. Refining companies regularly submit such data to Customs. Hence refinery production data already maintained by companies could be used as the basis for assessing duty liability.

8.47 The Committee believes that a practical system could be devised to handle toll refining. One way might be for the refining company to pay duty on all releases regardless of product ownership. This additional cost could then be passed on to the owner of the product. Such arrangements would be similar, in effect, to the way the current 'borrow and loan' system operates in relation to excise payments.

8.48 By moving the point of excise payment towards the refinery, the duration of Customs control over petroleum product would be considerably diminished. For this reason, the number of premises requiring Customs control would be reduced. Instead of controlling 156 licensed installations, as well as transport of product from refineries to these installations, Customs would only need to control nine or ten refineries because the product would be duty-paid beyond the refineries.

8.49 To ensure that local product is not disadvantaged by implementation of the proposal, customs duty could be collected on imported petroleum products, with an appropriate credit period, after release from the initial warehouse into which goods are entered upon importation. Under-bond transport to further warehouses would not be allowed.

8.50 The treatment of losses could become an issue if the point of excise payment were moved to the refinery. Currently, it is accepted that losses incurred in the process of transferring product from the refinery to the installation and losses within the installation are legitimate handling losses and therefore should not incur excise duty. It has been suggested that moving the point of excise liability back, would mean that rebates would

have to be sought for duty already paid on product lost in these areas. The Committee, however, is not convinced that the efforts put into the explanation and justification of losses by oil companies and the verification of losses by Customs are productive. In fact the Committee believes that time, effort and resources are being wasted in the handling, justification and validation of loss claims and that the current arrangements do not provide companies with sufficient incentive to minimise losses. The Committee believes that a reappraisal is required to determine exactly what this process is achieving and how a fair and sensible outcome might be achieved more efficiently.

8.51 The Committee suggests that if the point of excise liability were moved to the refinery, an adjustment should be made to dutiable quantities to compensate companies for duty which would otherwise be paid on losses. One approach might be to build into the formula for calculation of excise, an agreed percentage adjustment based on average historical losses, through the various stages of production, over the last few years. (This adjustment percentage would be calculated once only and from then on would be fixed. The total adjustment would always be granted regardless of what actual losses were at any time.) If such arrangements could be developed to the satisfaction of Customs officers and the industry, all those Customs resources currently dedicated to this area could be directed elsewhere. At the same time companies would have more incentive to avoid losses beyond the refinery because any product lost would be considered fully duty-paid and therefore worth more than the duty-unpaid losses under current arrangements.

8.52 The Committee recognises that moving the point at which duty is levied back to the refinery, would result in considerably increased costs for the industry since duty liability would be incurred several weeks earlier. To counter this the Committee suggests that some compensating arrangements such as an extension of the settlement period for excise payment, should be developed. The Committee considers that this calculation should be done by the parties who are best able to appreciate the intricacies of the industry and the Government's requirements, namely the companies concerned and the relevant Government departments. The evidence supplied to the Committee has placed the annual financing cost for the industry in the region of \$100 million, although estimates have ranged from \$70 million to \$200 million.

8.53 One problem raised by the industry is that there would be less incentive for companies to store product in depots downstream of refineries, if duty is to be paid earlier. However, if the new arrangements are designed so that companies are not disadvantaged relative to their current position then they would incur no greater cost by continuing to operate in the same way as at present. Companies may find commercial advantage in altering

their strategy to keep less stocks further downstream in the distribution process. This could be a strategic disadvantage in times of disrupted supply emergencies - a situation which could be addressed by specific emergency regulations. At other times there should be no particular problems with companies making commercial decisions about stock requirements at various points in the distribution system on the basis of meeting the market demand for their products and securing their market shares.

8.54 The Committee considers that the area of alternative methods of excise collection should be given more detailed examination. This examination should canvass alternative methods of collection of excise on motor spirit and other petroleum products, including the particular proposal for motor spirit for:

- a movement in the point of excise collection to the point of release of product from the refinery. This will require the design of systems for handling:
 - imported products; and
 - toll refining.
- compensation for oil companies for the earlier point of excise collection by extending the settlement period for excise payment. This period should be negotiated with oil companies so that there is not a net financial disadvantage as a result of the new arrangements, and
- a replacement of the processes currently used for handling loss claims by incorporating an automatic adjustment to the dutiable quantities declared, on the basis of average losses experienced in the past.

8.55 As mentioned earlier in this chapter the Auditor-General's main recommendation concerned installation of independent sealed meters so that Customs would have reliable data on the total production of petroleum products. This proposal was rejected by a Departmental feasibility study on several grounds, the main one being that the Department estimated the cost of a metering system to be \$750 000 for each product line.

8.56 The Committee is not convinced that the introduction of independent sealed meters can be justified in view of the care taken by oil companies themselves over the measurement of releases from refineries. The Committee welcomes the companies' own moves towards improving the sophistication of their measurement devices and control systems. The metering system at Caltex's Banksmeadow terminal is an outstanding example.

26. The Committee recommends that Customs seek sources of independent data to allow checks of revenue due against revenue collected. Wherever possible approximate estimates should be made against crude oil input figures and any available sales or usage figures.

CHAPTER 9

DIESEL FUEL

General Background

9.1 Arrangements for payment of excise on diesel were changed in 1982 leaving many of the comments of the Efficiency Audit Report no longer relevant.

9.2 Formerly, categories of users entitled to duty-free diesel would obtain certificates indicating their eligibility. Only agents were authorised to make duty-free sales of diesel fuel to certificate holders but they could also make duty-paid sales to other users. Agents were required to maintain records of all sales, duty-free and duty-paid. Excise payable by oil companies, on quantities of diesel leaving depots, was adjusted according to agents' schedules of duty-free sales.

9.3 The new arrangements were announced by the Treasurer in the 1982 Budget. Excise is now payable on all diesel fuel produced and therefore all sales are now made at the duty-paid price. However, certain users of diesel for off-road purposes are entitled to rebates to cover the excise component of this price. Processing of rebate claims began on 8 November 1982 with the aid of a new national computerised rebate processing system known as REEF which registers eligible users when they make their initial claim.

9.4 Under the new arrangements the categories of users eligible for rebates have been slightly altered compared with the users who were entitled to certificates under the old scheme. Categories eligible to claim a rebate of duty are the agricultural, mining, forestry and fishing industries, household users, medical and nursing institutions and aged persons homes. These new categories have led to a reduction in the number of persons eligible for duty-free diesel fuel.

9.5 The Department has provided information indicating that in 1982/83 there was a net increase in revenue of \$346.2 million as a result of the introduction of the new scheme. This was partly attributed to strengthened control and partly to the reduction in the numbers of eligible users.

9.6 At 14 March 1984 there were 125,107 registered eligible users of duty-free diesel fuel. From 17 August 1982 to 30 June 1983 gross excise revenue from diesel fuel was \$408.5 million and \$72.9 million was paid in rebates, representing 17.8% of total diesel fuel usage.

9.7 Under the new system Customs controls include the automatic checking of claims through the computer system. Computer checks are made for accuracy, duplication and comparability with previous claiming patterns and there is also a program of investigations of end users.

9.8. Initially, before the claimant population was known, investigations were mainly oriented towards users claiming particularly large amounts of rebate. However, it is taking much longer to establish the claimant population than was expected. This is partly due to the fact that there is no time limit on lodging claims.

9.9 The Department has advised that since July 1983, methods of selecting claimants for investigation are being developed on the basis of:

- . processing system rejections;
- . a risk assessment program;
- . processing area referrals based on use of profiles;
- . random selections; and
- . intelligence.

The Department also claims that 'Investigation procedures have been enhanced by the adoption of risk assessment techniques through the use of computer interrogation facilities to analyse claimants and claiming pattern variations under various parameters'.

9.10 In June 1984 Customs had 146 officers working on the diesel rebate scheme. These consisted of 104 processing staff and 39 investigation staff involved in States/Territories operations and 3 officers involved in Central Office.

9.11 The new arrangements appear to eliminate many of the problems that were associated with the previous scheme and simplify procedures considerably. In a submission to the Committee dated 12 August 1982,¹ the Department of Industry and Commerce stated that:

'The adoption of a rebate system has overcome most of the control weaknesses which existed under the previous certificate system. All diesel fuel is now duty paid when entered for home consumption and claimants within eligible categories must personally sign a declaration as to their usage in order to receive the rebate....

One of the more significant control aspects of the new scheme over the previous exemption certificate system is that it completely removes oil companies, their agents and fuel suppliers from having access to duty free fuel. This was a major area of abuse under the previous system and whilst savings cannot be accurately determined it is considered they are substantial.'

1 Minutes of Evidence, op. cit., p. 366.

The Committee's Comments and Recommendations

9.12 While material explaining the operation of the diesel rebate scheme was sought from the Department in the course of this inquiry, the Committee decided not to examine this area in detail. This decision was taken on several grounds:

- the problems associated with the actual collection of excise on diesel are similar to those associated with other products and have therefore been explored in the previous chapter;
- the payment of diesel rebates is not, strictly speaking, excise collection;
- the new diesel rebate scheme has as yet only been in operation for a relatively short period and is presumably still being developed and perfected; and
- the Auditor-General conducted an audit of the operation of the scheme in several States and reported in September, 1984. The Committee will scrutinise the item in the context of its consideration of that report.

9.13 Nevertheless the Committee does wish to make some general comments relating to this area. In particular, the Committee is concerned at the apparent complacency about diesel simply because this new system has been introduced and has eliminated some of the problems of the previous arrangements. Recognising that there are many advantages in the new scheme, the Committee nevertheless considers that the rapid introduction of new procedures always leads to problems and that therefore the system needs to be evaluated and monitored to ensure that its objectives are being met in the most efficient way possible. The Auditor-General's work in this area should provide the Department with a starting point.

9.14 The Committee considers that the weakest point in the diesel fuel rebate system lies in ensuring that the diesel which is the subject of the rebate is actually used in the specified applications. The Committee is not convinced that the new improved and streamlined rebate processing procedures, despite all their advantages, satisfactorily control this end user area.

27. The Committee recommends that the Department review the effectiveness of the administration of the diesel rebate scheme.

9.5 The Committee also wishes to stress that the diesel rebate scheme does not deal with the problems of actually levying excise on diesel production. The existence of the rebate scheme simply means that excise must now be paid on all diesel fuel produced. The problems of product control and validation of declared production, as discussed in Chapter 8, still remain.

CHAPTER 10

PETROLEUM PRODUCTS FREIGHT SUBSIDY SCHEME

General Background

10.1 During its consideration of excisable products the Committee became aware that there appear to be continuing problems with the petroleum products freight subsidy scheme. This was supported by information from both industry and Departmental sources. Some of the major oil companies in particular, have informally indicated that the continuing abuse of the freight subsidy scheme by some operators, particularly direct purchase agents, appears to be disrupting the market.

10.2 The Committee considers that the extensive discounting of petrol and diesel in some country areas lends credence to these allegations.

10.3 Consequently, the Committee decided to extend its terms of reference to include, in this inquiry, consideration of the petroleum products freight subsidy scheme which is also administered by the Department of Industry and Commerce. The Committee's consideration of this area concentrated on Queensland and northern New South Wales.

10.4 On 11 April 1984 the Committee sought a paper outlining the operation of the scheme. The following points, briefly describing the scheme, were taken from the Department's response:¹

1. the scheme was re-introduced in 1978 and subsidises the cost of transporting certain petroleum products viz. motor spirit, power kerosene, automotive distillate and aviation fuels to country locations;
- . each State and the Northern Territory has its own Subsidy Act under which Customs officers have been appointed to perform the duties of authorised officers ie. checking and certification of subsidy claims for payment and subsequent investigation;
- . the rates of subsidy are based on freight differentials determined by the Prices Surveillance Authority (PSA) formerly the Petroleum Products Pricing Authority and are calculated by deducting from the differential the margin paid by the consumer, currently 1.1 cents/litre;
- . the PSA regularly review freight differentials on a State by State basis;

1 Minutes of Evidence, op. cit., p. 563-571.

- there is a Schedule of Subsidies for each State and the Northern Territory which lists names of places and the rates of subsidy payable on the sale and delivery of eligible products;
- before oil companies and direct purchase distributors may claim subsidy, they must be registered as distributors under the scheme and it is a condition of registration that they must give an undertaking to pass on to the purchaser the benefit of any subsidy received;
- registered distributors lodge their claims for subsidy, which must be supported by details of sales at the various places, with Customs offices in the capital cities of the various States and the Northern Territory;
- the bulk of the subsidy is paid to oil companies who sell petroleum products direct to consumers and also to direct purchase distributors who in turn resell the product to their customers;
- direct purchase distributors claim a subsidy based on the difference in rates between the place at which they purchased the product from the oil company and the place at which they delivered it to the consumer;
- all claims are subjected to a face of claim check, certified for payment by an authorised officer and then forwarded to the State Treasury for payment;
- selected claims are also subjected to post payment checking both in the office and the field.

sidy
 of
 s of
 ases
 and
 items
 posed
 . It
 were
 not

e to
 ; the
 n in
 .n to
 nents
 e or

sible
 fact
 could
 over

ng on
 chase
 eason
 sales
 | can

also
 .sbane
 y are
 final
 ge of
 island
 .onger
 s can
 road

have
 agents
 ht be
 scheme

10.5 The freight subsidy can be applied for in multiple stages. For example, if one operator moves product from Brisbane and sells it to a direct purchase agent at Destination 1 the freight subsidy from Brisbane to Destination 1 can be claimed by the first operator. The second operator can then move the same product to Destination 2 and sell it and therefore claim the freight subsidy which is calculated as: (the subsidy from Brisbane to Destination 2) minus (the subsidy from Brisbane to Destination 1). However, if a third operator then moves the product back into the Brisbane area to sell, he is not expected to repay the subsidy already paid out.

10.6 The administration of the scheme is not computerised. A feasibility study into the computerisation of the administration of the scheme has been undertaken by the Systems Division of the Department. The feasibility study is currently being examined by the Resources Excise and Bounties Branch of the Department prior to consideration by the ADP Policy Committee.

10.13 In response to these concerns (as discussed at the hearing on 7 May)¹ the Department informed the Committee that the Prices Surveillance Authority had announced an inquiry into petroleum product pricing and that the Department of Industry and Commerce had been invited to make a submission to the inquiry specifically on the petroleum products freight subsidy scheme.

10.14 At the same hearing,² the Treasury representative informed the Committee that all the States and the Commonwealth were co-operatively looking at the avoidance and evasion of State taxes.

28. The Committee concludes that abuses of the Petroleum Products Freight Subsidy Scheme are not under control and the deterrents are inadequate. The Committee recommends:

- immediate substantial increases in penalties;
- the freeing of more resources from other areas for transfer to investigation work in this area; and
- the application of ADP resources to the administration, control and monitoring of the freight subsidy scheme.

29. The Committee recommends that a comprehensive review of the Petroleum Products Freight Subsidy Scheme be undertaken within a year of the introduction of the other recommendations. The review should include consideration of:

- the extent of abuses and their revenue implications;
- the costs of administering the scheme as well as the costs of increasing surveillance and investigation to plug the apparent gaps;
- means of streamlining procedures and requirements to minimise opportunities for abuse;
- the implications, cost and benefits of abolishing the scheme; and
- alternate ways of achieving the intended outcome.

1 Minutes of Evidence, op. cit., p. 561.

2 ibid., p. 572.

APPENDIX 1

DETAILS OF THE DEPARTMENT'S OVERALL STRATEGY FOR ACHIEVING AIMS
AND OBJECTIVES

Material provided by the Department of Industry and
Commerce on 8 September 1983.

a) Details of the Overall Strategy for Achieving Aims and Objectives

In order to prescribe a control program that would seek to overcome the management deficiencies described by the Auditor-General, the Department as a first step, set about identifying the elements of such a program. The results are at pages 61-62 of our submission and outline the key elements of a control program which the Department believes is capable of implementation progressively in the Inland Services area throughout Australia.

To achieve the ideal in a practical sense will be a long term process. The Department has not yet promulgated a timetable of activity that would see the finalisation of each element of the system. Because of our limited experience in this field, Inland Services considers that a flexible approach is necessary as it is inevitable that with experience and accumulation of further knowledge the parameters of the system will need to be modified.

Having identified what is regarded as the overall objective, Inland Services in Central Office set about identifying some short term objectives. These have included the development of a national training program in conjunction with State Officers; the means to improve investigation techniques particularly in the area of computerised record keeping; the maintenance of uniform cost-effectiveness data by State Officers; an effectiveness review of warehousing operations; commencement of industry reviews beginning with the tobacco industry.

Inland Services appreciates that achievement of the overall objectives will be best achieved through a risk management program that has clearly understood components, which concentrates on rating risks, allows the flexible allocation of resources, measures the results of all activities and is uniform in its application.

The components of the system have now been determined and defined and the Branch is in the process of developing a practical pilot model with the assistance of the Collector of Customs, Queensland. Some of the components that should play an important role in any decision as to resource allocation will become available in due course. For example, a key indicator for the future will be the results of company investigations using the systems-based investigation technique supported by computer audit software. Information on this project will progressively become available over the next 12 months. The first 12 month training program under the direction of a consultant (Touche Ross and Co.) will now commence in early October 1983. The systems-based investigation technique will be continually evaluated during this 12 month period.

It is proposed to submit a detailed evaluation of the 12 months exercise together with recommendations for the future, to the (Collectors of Customs) Conference for consideration in September 1984.

Should it be decided by that Conference which is chaired by the Comptroller-General of Customs to introduce nationally throughout all areas of Inland Services operations systems-based investigation supported by ADP software packages, then all Licensees throughout Australia under Inland Services control will be progressively investigated using the new investigation techniques or methods. This will be a long term project which will require significant training of staff and would take several years to complete.

In the meantime current investigation procedures will be utilised in conjunction with the new investigation techniques that are being developed to ensure protection of the revenue during this period.

The components of the risk management system are outlined hereunder:-

- (1) Inland Services Programs
- (2) Program aims and objectives
- (3) Control areas
- (4) Premises
- (5) Revenue obligation
- (6) Risk-rating
- (7) Cost-effectiveness
- (8) Effectiveness measurement
- (9) Staff
- (10) Control-time allocated
- (11) Work-load indicators
- (12) Results of individual company investigation and industry reviews
- (13) Intelligence assessment
- (14) Performance measurement
- (15) Efficiency
- (16) Effectiveness

Note: (A) Elements (1) to (13) are separate and quantifiable. Element (14) is really a review process and elements, (15) and (16) are qualitative assessments integral to the performance of elements (1) to (13).

(B) The Risk Management system implements the overall "Control Strategy to Achieve Objectives" outlined in the Inland Services Philosophy and Policy Statement - see page 24 of Departmental submission of 12 August 1983.

The formal commencement of the system should be possible by January 1984 on a national basis following evaluation of the Queensland pilot period. Each of the components will be introduced as soon as practically possible. Implementation of the system in its entirety i.e. encompassing all companies liable to pay excise duties or deferred customs duties will be a long term project which will take up to four years to fully implement.

Because of the priority that attaches to the development of the national risk management program the Branch has had to revise its attitude to the industry-by-industry reviews.

The results of these reviews provide important information that must be fed into the risk management system. However, the first action should be to complete the fundamental steps of the risk management program, that is, identify objectives and allocate person-years to each activity for each State and Central Office. Assisting the States prepare these programs has high priority and the industry-by-industry reviews will be undertaken as soon as practicable under the supervision of the Director (Operations) Inland Services Branch.

**SUBMISSIONS ON THE PROPOSAL TO COLLECT
EXCISE REVENUE AS SALES TAX**

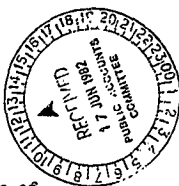
- . Commissioner of Taxation (16 June 1982)
- . The Department of the Treasury (19 October 1983)



CANBERRA, A.C.T. 2600
TELEPHONE 63 9111
TELEX 62187

REFERENCE: 1 ST 7/11

COMMISSIONER OF TAXATION



Mr M.J. Talberg,
Secretary,
Joint Parliamentary Committee of
Public Accounts,
Parliament House,
CANBERRA. A.C.T. 2600

16 JUN 1982

REPORT OF THE AUDITOR-GENERAL ON AN EFFICIENCY

AUDIT : THE COLLECTION OF DUTIES AND

DEFERRED CUSTOMS DUTIES

Your Reference : 1982/7

You have sought comments on the Report of the Auditor-General on an Efficiency Audit - The Collection of Duties and Deferred Customs Duties - to the extent that that report relates to matters under the control of this Office. The report recommends, among other things, that "In view of the difficulties associated with control over excise revenue the relative advantages of an extension of sales tax vis a vis the current excise duty should be considered for review by the appropriate authorities".

2. The recommendation in the report in relation to sales tax is in its context apparently restricted to the possibility of collecting by way of sales tax, revenue now payable as excise duty on spirituous beverages including brandy, rum, whisky, gin, vodka and liqueurs. The report suggests that the attraction of this option would be that it would no longer be necessary to apply controls to producers, as the existing control system applied to sales tax collection at the wholesale level would be used. Spirituous beverages are at present subject to sales tax at the rate of 17.5%.
3. Sales tax is a single stage tax designed to fall, primarily, on sales by wholesalers and manufacturers (producers) to retailers. The intention is that all goods that are produced in, or imported into Australia for use or consumption in Australia shall bear the tax unless they are specifically exempted from it.
4. Although termed a sales tax, the levy is not limited to sales only. Imported goods are taxed at time of importation by retailers and consumers. Goods applied to a taxpayer's own use are taxable. Although probably not relevant in the present context, goods leased by taxpayers are also subject to sales tax.

5. The tax is payable by three general classes of persons. They are manufacturers, wholesalers and importers. The first two categories, i.e., manufacturers and wholesalers, are required to register with the Taxation Office in each state in which they have a place of business as a manufacturer or wholesaler. Dispensation from registration is granted where a person is only dealing in exempt goods.

6. Registration entails the issue by the Commissioner of a numbered certificate of registration which plays an important part in the sales tax system, being the means by which the tax retains its character as a single stage tax. By quoting his certificate of registration in the prescribed form a manufacturer purchases his raw materials free of tax. Similarly a wholesaler also obtains his trading stock free of tax. It is therefore only at the point of the last wholesale sale that the tax becomes payable. Therefore, a manufacturer selling to a wholesaler would be given a "quotation of certificate" by the purchaser and would not be required to pay tax. When the wholesaler sells to a retailer he charges tax to his customer and accounts for that tax on monthly returns lodged with the Taxation Office. Payment of the tax accompanies the return.

7. In the context of importation of goods, those who are manufacturers may acquire imported raw materials free of sales tax by quoting their certificate when clearing the goods for home consumption. Wholesalers similarly clear imported goods free of sales tax, but of course charge sales tax when they in turn sell to retailers. As noted earlier, retailers and consumers who import goods pay sales tax at the time the goods are entered for home consumption.

8. It is relevant to note that merchants who undertake the blending and dilution, or merely the dilution, of overproof spirits so as to derive a product suitable for consumption are manufacturers for the purposes of the sales tax law. Therefore an importer of overproof spirits to be diluted, blended and bottled in Australia would enter the goods at customs under quotation of certificate free of sales tax. Import duty is payable when the goods are cleared from bond, i.e. entered for home consumption. The end product would be taxed on the occasion of the last wholesale sale in Australia.

9. Tax is payable on what is termed the sale value. In general terms that is the amount for which the goods are sold. Because of the variety of transactions which attract tax, the sale value provisions in the law are fairly complex but as a general statement, where the taxable transaction is other than a sale by a wholesaler to a retailer, the law seeks to apply tax on an amount which represents the fair wholesale value of the goods.

10. Sales tax is generally payable to the Taxation Office 21 days after the month in which the last wholesale sale takes place. By contrast, excise and import duties are payable when the goods are entered for home consumption, i.e., removed from Customs control. There is a settlement period of 7 days.

11. There are at present three rates of sales tax - 5%, 17.5% and 30%. There is also a range of goods, covered by the First Schedule to the Sales Tax (Exemptions and Classifications) Act, which are exempt from sales tax.

12. For present purposes it is relevant to note that whisky, brandy and other potable spirits, whether imported or locally produced, are taxable at 17.5%, as are imported wines and beers. Australian produced wines and beers are exempt from sales tax. Tobacco, cigarettes and cigars and certain petroleum products such as crude oil, petrol and kerosene are exempt from sales tax whether produced in Australia or outside Australia. However, other products such as diesel fuel are only exempt from tax if produced in Australia.

13. At present the excise on spirits is collected on a unit value basis, i.e., a prescribed amount per litre of alcohol, which does not differentiate between cheap and expensive spirits. An ad valorem sales tax results in a greater amount of tax being paid per bottle on more expensive spirits. The present sales tax on spirits accordingly operates that way.

14. To replace the revenue derived from excise duty with a sales tax impost would require two basic changes to the sales tax law. The first would be that a number of excisable goods at present exempt from sales tax would need to be made taxable.

15. The second would be a restructuring of the sales tax system to accommodate the relatively high amounts of revenue to be collected from the products concerned.

16. A sales tax to replace the estimated loss of excise revenue on spirituous beverages, as seems to be suggested at page 12 of the Audit Report, would under the present structure of the sales tax legislation involve imposition of a sales tax rate in excess of 200%. That is to be compared with 30% which is the highest rate of sales tax presently in force. It would be possible from an administrative viewpoint to alter the law to introduce a rate of tax of say 200% but there would be wider considerations to be taken into account before such a rate of tax were adopted. Whether the one rate of sales tax would be appropriate for spirits of varying grades and qualities may need particular examination.

17. Another possibility could be to introduce a separate sales tax Act to impose a sales tax comparable with the basis of the present excise duty, viz., \$18.75 per litre of alcohol. Although not an ad valorem tax such levy could be administered in the same way as the existing sales tax. The omission of an ad valorem base would, however, mean that, unlike the present sales tax, legislation would be required to impose some form of indexation of the rate scale to keep pace with inflation. In times of high inflation annual increases would be large,

thus encouraging stockpiling in the period immediately preceding the increase, with consequential effects on tax revenue. More frequent adjustments, for example quarterly, would reduce the likelihood of stockpiling but would be administratively more costly.

18. In this case the administration of the tax could be brought under the control of the Taxation Office, and this would replace the controls presently exercised by the Bureau of Customs. Such a change would involve reducing the present controls and relying on regular audits by taxation officers to maintain compliance. At present, such audits are conducted on a cyclical basis ranging from 3 to 8 years, depending upon past compliance records of each taxpayer.

19. Bearing in mind that under the present sales tax system the relevant transaction is the last wholesale sale, it is the wholesalers rather than the producers who would be required to account for tax on spirits. A change to an exclusively sales tax impost on such goods would substantially increase the amount of revenue collected from such wholesalers, which would warrant a shortening of the period between cyclical investigations but would not otherwise materially add to the workload of the Taxation Office, given that such wholesalers are already accounting for tax on their sales of spirits.

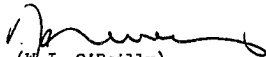
20. Another aspect of a switch in the point of collection would be some postponement in the receipt of revenue from spirits. If the additional sales tax yield from spirits were at the estimated yield of \$125m for excise for 1981-82 there would be a postponement in collections in the first year of some \$10-15m.

21. One further matter which would require attention if a change from excise to sales tax were to be made concerns the implications of the change for import duties. It would seem to follow that revenue derived from the excise on imported spirits should also be switched to collection via a sales tax. In respect of overproof spirits referred to in paragraph 8 above, the diluting, blending and bottling is carried out in bond so that when the diluted product is cleared from bond it is subject to import duty as are other dutiable goods when cleared from bond. The diluting and blending of overproof spirits constitutes manufacture for the purposes of the sales tax law. The blended spirits are taxed on the occasion of the last wholesale sale after the blending and irrespective of whether the blended spirits were cleared from bond at some earlier point in time. If the last wholesale sale takes place in bond then tax would be payable upon the goods being cleared from bond.

22. Yet another aspect for consideration would be that, against the background that excise and the excise component of customs duties on spirits are similarly structured and bear corresponding amounts of duty, a divergence in the amount of revenue on imported and local spirits would emerge if sales tax on local spirits (in lieu of excise) were to be imposed on a basis that varies from that for a continuing import duty on spirits.

23. In short, the question to be considered could become one of whether both import and excise duties on spirits should be displaced in favour of a sales tax.

24. Finally, the Audit report has suggested that the Department responsible for excise and the Taxation Office should investigate the possibilities of collection, by way of sales tax, of revenue now payable as excise duty. There are important questions of Government policy involved in the question - some of them being touched on above - and the Taxation Office would not feel it appropriate for it to carry out the suggested investigation without the Government having sanctioned such a course.



(W.J. O'Reilly)
COMMISSIONER OF TAXATION



REFERENCE NO.

The Treasury,
Canberra, A.C.T. 2600

TELEPHONE 53 9111

Mr M.J. Talberg
Secretary
Joint Parliamentary Committee
of Public Accounts
Parliament House
CANNBERRA ACT 2600



INQUIRY INTO THE COLLECTION OF EXCISE AND DEFERRED CUSTOMS
DUTIES

I refer to your memorandum of 19 July 1983 inviting a submission from this Department to the above inquiry on the suggestion in the Auditor-General's Efficiency Audit that there be an investigation of collection by way of sales tax of revenue from potable spirits currently collected as excise duty.

2. As you will have gathered from the 1983-84 Budget decision to index traditional excise rates, the general issues of maintenance of the real value of excise collections and the relative suitability of sales taxes and excises have recently been the subject of Ministerial consideration in the Budget context. I regret that this, together with the peak in pressures relating to the Budget, has prevented any earlier response to your request. However, I am now able to set out some general observations on this issue which may be of use to the Committee.

3. The major distinction between raising a certain amount of indirect tax revenue as a sales tax rather than as an excise lies in the difference between percentage (or ad valorem) tax rates such as in the sales tax system, and per unit rates as in the excise system. This distinction gives rise to two underlying economic issues.

4. The first is that an ad valorem tax imposes an equal proportional burden on all items within the dutiable product range; a per unit tax imposes an equal absolute burden but unequal proportional burdens. Within a dutiable product range, it is therefore felt that an ad valorem tax is more appropriate on resource allocation grounds in that it should not influence price relativities between less and more expensive items.

5. Second, ad valorem tax rates automatically and continuously retain their real values in the presence of inflation, whereas per unit tax rates decline in real value unless their nominal rates are increased to keep pace with inflation. There have not been sufficiently regular adjustments to per unit rates of excise in the past but the six monthly indexation arrangements introduced in the 1983-84 Budget will ensure effective maintenance of real per unit excise rates, albeit with some lags and with separately identifiable price effects. Even so, ad valorem rates would achieve automatic adjustment to rising prices and would do so without separately identifiable price effects.


6. If one were seeking to introduce a tax on potable spirits from scratch, the foregoing arguments would work strongly in favour of an ad valorem or sales tax type impost. However, the fact that Australia already has a high level of excise taxation on potable spirits considerably complicates the issue by raising transitional adjustment problems for the respective industries. This is because the structure of potable spirit consumption, production and imports has by now adjusted to the per unit tax distortions outlined above. That is, low valued products which bear the brunt of per unit excise taxation have been reduced to a lesser market share than they would have if there had been a single ad valorem sales tax rate which raised the same amount of total revenue. Such a change in the form of taxation could set in train some changes in industry structure, to the advantage of consumers, producers and importers of cheaper products and to the disadvantage of more expensive products such as cognacs, malt whiskies and the like.

7. Once these adjustments were complete, there would be a more efficient allocation of resources in the potable spirits industry as the distortion of consumers' product preferences would be removed. Nevertheless, the Committee would need to be aware that a transition to collecting the excise revenue from potable spirits by means of an increase in sales tax would involve some industry adjustments.

8. There is also a transitional revenue consideration relevant to any move to collecting excise revenue from potable spirits through variations to the sales tax arrangements. As noted by the Australian Taxation Office in its memorandum of 16 June 1982, sales tax credit terms (at an average of 36 days) exceed the credit terms for the traditional excises (which average 3 $\frac{1}{2}$ days). Therefore transition to a higher sales tax rate which was revenue equivalent in terms of the weekly or annual flow of collections from potable spirits would, under present credit term arrangements, nonetheless cause a one-off loss of revenue in the year of implementation of the order of \$10 million.

9. Finally, it should be noted that the economic efficiency arguments outlined above in favour of ad valorem or percentage tax rates such as in the sales tax system, rather than per unit tax rates such as in the excise system, are applicable in principle to the full range of products subject to the traditional excises. While it is obvious why the Auditor-General's Efficiency Audit Report focussed on potable spirits in its recommendation - potable spirits being the only excisable commodities also already subject to sales tax - the considerations outlined above would also be applicable to other excisable products.

10. I trust the Committee will find these observations of some assistance in its deliberations.


E.A. Evans
First Assistant Secretary
19 October 1983

APPENDIX 3

SUBMISSION BY THE DEPARTMENT OF INDUSTRY AND COMMERCE
ON THE AUDITOR-GENERAL'S COMMENTS ON WAREHOUSING IN HIS
SEPTEMBER 1983 REPORT (19 JANUARY 1984)



MINUTE PAPER

C83/7781

19 January 1984

-Mr M.J. Talberg
Secretary
Joint Parliamentary Committee
of Public Accounts
Parliament House
CANBERRA ACT 2600

JOINT PARLIAMENTARY COMMITTEE OF PUBLIC ACCOUNTS
INQUIRY INTO THE AUDITOR-GENERALS REPORT OF
SEPTEMBER 1983

Enclosed is a submission on the matters raised in paragraph 15.1
of that Report concerning warehousing as requested by your
memorandum of 16 November 1983.

A list of possible witnesses is :

NAME	DESIGNATION
Mr B.L. Cody	Assistant Secretary Inland Services Branch

(H. BATES)
First Assistant Secretary
Inland Revenue and Dumping

JOINT COMMITTEE OF PUBLIC ACCOUNTS
Inquiry into the Auditor-General's Report
September 1983

Submission by the Department of Industry and Commerce

The following details are submitted in relation to specific matters raised in paragraph 15.1 concerning warehousing in the September 1983 Report of the Auditor-General.

1. Collection of Fees

The Auditor-General detected certain deficiencies in procedures for recording and collecting amounts payable to the Department in the States of Western Australia and New South Wales.

Both States have since instituted recording systems to ensure that all fees payable are received within the time specified by the Customs Act and Regulations.

Western Australia has instituted checks on calculations of pro-rata licence fees and has separated duties in the cash receipts area.

2. Warehouse Performance

The Auditor-General detected that within the New South Wales operations investigation officer assessment reports were not placed on Warehouse licensing files in every case. The Auditor-General suggested that assessment reports should be required in all cases and that they should contain a recommendation in respect of renewal of the licence.

New South Wales now assess all licenced premises from April each year prior to re-licensing and this assessment is attached to the company licensing file.

Central Office is currently developing a standard assessment report format for incorporation in all states.

3. Review of Fees

The Auditor General noted that fees had not been reviewed or revised since 1977 and that certain fees charged did not reflect the Department's cost recovery policy.

Licence fees were uplifted from 1 January 1983 although prior to this increase the level of fee had remained unchanged from 1 November 1977. The increased fee reflects movements in the Consumer Price Index since 1977.

A further review of warehouse licence fees is to be undertaken. On 12 December 1983 the Public Service Board indicated its agreement to the Department engaging a consultant to undertake an independent review of the basis for levying fees and to determine an appropriate quantum of fees. The review will canvass such aspects as the possibility of indexing licence fees and the recovery in full of costs incurred in the control and maintenance of the licenced warehouse system. It is expected that tenders for the consultancy will be called shortly.

4. Eligibility Criteria

Section 31 of the Customs Act provides that a Collector shall not grant a warehouse licence if the applicant for licence or an employee of the applicant who would participate in the management and control of the warehouse is not a fit and proper person to hold or participate in the operation of a warehouse licence.

The Auditor-General detected that within Western Australia and Queensland operations, security checks were not, in all cases, carried out in respect of this requirement.

Both States now carry out the required security check of key personnel in every instance.

Inspections of Warehouses

The Auditor-General raised queries in relation to:-

1. Risk Assessment

The Department is currently implementing a nationally co-ordinated risk management program in the area of warehouse control. The objectives of this program are:

- . Incorporation of clearly understood components.
- . Concentration on rating risks.
- . Flexibility in the allocation of resources.
- . Measurement of the results of all activities.
- . Uniformity of application.

Full details of this program have been provided to the Joint Committee in its examination into the Auditor-General's Efficiency Audit on the Collection of Excise and Deferred Customs Duties.

Trials of the program are currently being conducted in warehouses in New South Wales and Queensland it is proposed that this program be extended to all States in 1984.

2. Documentation

An integral part of the risk management program is uniform documentation which readily allows for the measurement of results. A standard risk rating form and an Investigation Officer's report form are being developed in conjunction with the New South Wales and Queensland trial programs with the intention that uniform documentation be introduced on a national basis.

3. Program of Inspections

The Auditor-General detected that the program for inspection of warehouses was in arrears in New South Wales and Western Australia.

The inspection program within Western Australia is now up to date and will be kept that way wherever possible. Where delays become unavoidable, revenue risk assessments will determine priorities for warehouse inspection.

New South Wales reviewed the progress of inspection programs in March 1983 and it was found necessary to introduce contingency check guidelines that were priority oriented mainly due to a loss in manpower with officers undergoing training in conjunction with the introduction of the inspection concept throughout the Department. This revised inspection program is now substantially complete.

4. Storage of Goods

Customs Regulation 92(2) provides that no duty paid or free goods shall be received into any licensed warehouse without the special authority of a Collector. Permissions granted by a Collector contain certain requirements which must be adhered to by the permission holder in the storage of such goods.

The Auditor-General detected some instances within the New South Wales operation where the requirements for separate storage of dutiable, and duty paid or duty free goods in warehouses were not being fully adhered to.

4

Arrangements for the storage of duty paid and free goods under Custom Regulation 92(2) permission was examined by a Conference of Assistant Collectors Inland Services in December 1982. In accordance with the recommendations of that Conference programs have since been introduced by Collectors to ensure that permissions exist only in cases of demonstrated need and that attention is given to the receipt into warehouse of duty paid or free goods outside the terms of permissions issued under Customs Regulation 92(2).

3. Training of Inspection Officers

A standard Inland Revenue training program has now been introduced on a national basis. Each training course includes elements of investigation training and risk management techniques. Courses were run in Brisbane and Melbourne in November/December 1983. In 1984 6 further Inland Revenue Courses, 3 Alcohol Specialist Courses and 7 Petroleum Specialist Courses are programmed in various State Capitals. These courses will cater for officers from all States.

Other Matters

1 Internal Audit

Warehousing is programmed for Internal Audit in New South Wales, Victoria and South Australia in the 1983/84. Internal Audit Plan.

2. Customs Regulations

A working party to consider a general revision of the Regulations relating to warehousing comprising representatives from New South Wales, Victoria and Central Office has identified areas where it is considered Regulations are required or amendments are necessary. Before seeking appropriate legislative amendment proposed changes will be circulated to all State offices for comment.

3. Internal Check

The Auditor-General found that Internal Check programs were in arrears and deficient in certain areas in both the New South Wales and Western Australian operations.

In Western Australia Internal Check programs have been re-written to cover amended procedures and to provide for an evaluation of the effectiveness of systems and controls.

New South Wales is currently reviewing the programs in regards to basic philosophy and legislative foundation. The review will embrace the mechanics and appropriateness of the checks and address the level of Officer who is to perform each particular check.

4. Computer Controls

The Auditor-General has highlighted inherent deficiencies in Departmental Computer Controls, specifically in relation to the use of Warehouse Code File.

The Department's ADP redevelopment timetable allows for the incorporation of a "password" facility for "in-house users" in 1935.

Problems have occurred in some States in relation to rejection of entries and also with the manual raising of debit notes for the collection of the variable portion of warehouse licence fees. Central Office now supplies monthly to each State a printout of the Warehouse Code File which is used to cross check manual records.

Redevelopment currently being undertaken by the Systems Division of the Department, of the Warehouse Code File will act to alleviate the identified problems.

5. Movement of Goods

A Departmental Working Party established to review the overall operation of the underbond removal system including the scope for computer monitoring of underbond removals has further developed the Permissions Profile System as follows:-

- An ADP program has been developed for documentary control of undocumented cargo moving interstate.
- Minor clerical problems presently exist within the program and as a result the system is being evaluated for final proving.
- Once proven the priorities given for adding to the system are:
 - (a) Movement of undocumented cargo interstate
 - (b) Movement of undocumented cargo intrastate
 - (c) Movement of documented cargo (ie warehoused goods)

The Department has accorded a high priority to the development of this system.

Whilst the matters reported on by the Auditor General refer principally to warehousing operations within the States of New South Wales and Western Australia the report has been brought to the attention of all other States. Follow-up action will be initiated on a national basis to ensure review of those areas of operation identified in the report.

January 1984

APPENDIX 4

POSSIBLE ALTERNATIVES TO THE EXISTING BONDING SYSTEM

Material provided by the Department of Industry and
Commerce on 16 February 1984.



DEPARTMENT OF INDUSTRY AND COMMERCE

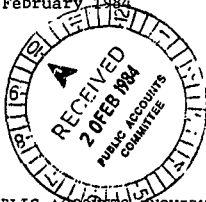
CANBERRA, A.C.T. 2600 TELEGRAMS: INDYCOM TELEX: 62854 TELEPHONE 72 3944

In Reply Quote C83/4332

1/6 February 1984

The Secretary
Joint Parliamentary Committee
of Public Accounts
Parliament House
CANBERRA ACT

2600



JOINT PARLIAMENTARY COMMITTEE OF PUBLIC ACCOUNTS ENQUIRY
INTO THE AUDITOR-GENERAL'S REPORT ON AN EFFICIENCY AUDIT
ON THE COLLECTION OF EXCISE DUTIES AND DEFERRED CUSTOMS DUTIES.

I refer to your letter of 14 October 1983 dealing with matters raised at the public hearing of 21 September 1983 on the above subject.

The attached submission is in response to your question number 17 requesting a paper on the possible alternatives to the existing bonding system.

It would be appreciated if this response could be treated as confidential as any public release of the document could cause uncertainty in industry because of some of the options outlined. The document should be regarded as an "options" paper and not providing any specific or positive direction for warehousing policy under active consideration by the Department of Industry and Commerce at this time.

(H. Bates)
First Assistant Secretary
Inland Revenue and Dumping

OPTIONS TO THE BONDED WAREHOUSE SYSTEM

INTRODUCTION

The Joint Parliamentary Committee of Public Accounts (PAC) has requested a discussion paper on possible options to the current bonded warehouse system.

This arose from the PAC's inquiry into the Auditor-General's report on the collection of excise and deferred customs duties.

Specifically, the PAC requested:

"A paper on possible alternatives to the existing bonding system (pages 466 and 467 of transcript). Please include assessments of the implications (in terms of impact on industry and cost savings to Government in the control area of:

- abolishing all bonding arrangements (assuming financial compensation is provided through extended credit or reduced duty)
- restricting the use of bonds to 'time-up' cargo and maturing spirits only (once again assuming compensation as above)."

SCOPE OF THIS PAPER

This paper examines, in advisory terms, possible options to the existing bonded warehouse system. A number of schemes used in other countries are outlined. Discussion is then opened on alternative methods of money collection and future developments.

BACKGROUND

The subject of warehousing policy was addressed at the 1971 Collectors' Conference. A proposal was tabled to abolish the existing warehousing system and institute a credit scheme. A working party was established in Central Office to examine the proposals. After consideration of States' reports the Working Party recommended that the proposal of a credit scheme be deferred until necessary ADP access was available. In the meantime, a national policy was developed for the current warehousing system.

CURRENT SYSTEM

In seeking a balance between the effective administration of the customs laws, and the right of organisations and individuals to carry on lawful business, the objectives of the department's customs administration lay down that, as far as is achievable, the department will ensure:

- . the protection of Australian industry by:
 - the administration of tariffs, quotas, and anti-dumping action; and
 - the granting of by-law (tariff) concessions, and the payment of bounties on certain goods produced in Australia;
- . that the Commonwealth receives, on time, its correct entitlement to revenues - no more and no less;
- . it assists in the effective maintenance of certain aspects of the Australian community's economic, social and physical welfare by:
 - the prohibition and restriction of certain imports and exports, and
 - the enforcement of quarantine restrictions.

The establishment of bonded warehouses arises from the legal requirement that duty not be levied until goods are entered for home consumption¹. The primary function of warehouses, is to provide commerce (and industry) with an option of deferring payment of customs or excise duties until the goods are actually required to enter the market place or, in the case of such things as components, are to be used in a manufacturing process. The system also provides commerce with a facility to hold particular goods in bond which are subject to quota restrictions pending allocation of quota. This is particularly relevant in the case of motor vehicle imports.

A brief history of warehousing is provided at Attachment A.

Warehouse licences are granted for a range of permitted activities in bond:

- . general (public) warehousing of goods;
- . private warehousing of goods which are the property of the licensee;
- . machinery - for warehousing machinery and similar heavy or building goods;
- . manufacturing (project) - for warehousing goods for such use under conditions prescribed, in a warehouse used in any manufactured goods trade or process or for the carrying on in such warehouse of any trade in manufactured goods or process of goods; and

1. Section 132 of the Customs Act 1901.

In addition, the Department operates places of security purely for the storage of seized and condemned goods, and are not in competition with private warehouse operations.

Warehousing may also provide the owner of imported goods with a constant flow, rather than an intermittent flow of those goods for production. However, for this privilege, the importer must pay certain licence and entry fees, in addition to the duty payable. Also, the importer may experience added inconvenience by not being able to store the goods outside the registered warehouses, even though provision for removal of goods to transit warehouses, for short periods of time, exist.

The operational concept which is the linchpin of Customs control over excisable products and licensed establishments is known as Commodity Control. The system became operational in 1968 after a series of trials in various industries.

Overall control is maintained through random and selective examinations of the normal business records of industry and commerce and supplemented by random checks of goods and physical operations. Customs officers are no longer in routine attendance at licensed premises, nor do Customs keep comprehensive records of licensees' operations.

The extent of examinations and checks at particular establishments varies and is based on continuing evaluation of the risks to revenue associated with particular classes of goods and/or operations and the reliability of individual firms.

Where appropriate, periodic accounts of activities are furnished by firms in place of individual accounts for separate transactions and approval of repetitive operations is given on a continuing basis in place of specific notifications.

The cost of administering the warehouse system in 1982/83 is estimated to be in the order of \$3.5 million, and directly involves some 80 positions within the Central Office and the State Offices of the Department. In 1982/83 revenues collected amounted to \$8970 million, comprising Customs and Primage Revenue of \$2064 million, and Excise Revenue of \$6906 million². The warehouse system would have directly collected \$600 million of this in Customs duty in 1982/83.

Licensed Customs warehouses pay annual fees of \$1900 and \$7 for each entry. Based upon 1200 warehouses, annual Commonwealth revenue would be approximately \$2.3 million in licence fees and \$0.4 million for entries - total annual revenue of the order of \$2.7 million. The policy is to aim for a 100% cost recovery of surveillance by Inland Services staff.

2. Customs and Excise Revenue, Australia, July 1983, ABS Catalogue No. 5425.O. November 1983.

The fees quoted were established in 1983. The Public Service Board has approved the Department taking steps to engage a consultant to undertake an independent review of the basis for levying fees and to determine an appropriate quantum of fees.

Excise warehouses pay annual licence fees of \$10. Based upon 200 warehouses, annual Commonwealth revenue would be \$2000.

There is the obvious benefit to an importer of goods, in deferring payment of duty, however any quantification of this benefit will need further work; savings to the importer arising from interest payments on borrowings to pay duty, and from uninterrupted production.

Some other factors need to be considered; the time goods remain in a warehouse (the dwell time), the type of goods, and the potential duty payable on these goods. A pilot exercise was run in 1982³, and showed that, nationally, 67.3% of customs dutiable goods were cleared within two months of lodgement. The State figures were in the range of 45% in South Australia to 93.3% in the Northern Territory. Information on the potential value and the type of goods was not available, and a detailed survey would need to be undertaken to obtain it.

ALTERNATIVE SYSTEMS USED OVERSEAS

This section looks at alternative systems in use overseas. It should be remembered that Customs legislation in a number of the countries examined varies greatly from that in Australia.

When examining an alternative to the existing system, the basic criteria of duty deferment and a means of collecting duties payable, must be adequately catered for.

Japan - Warehouse System

An examination of Japanese Customs law showed⁴ that while there were differences in the types of bonded warehouses and examination procedures, the only duty deferment method available was that of storage in a bonded warehouse; duty being payable on clearance from the warehouse.

There are 5 types of warehouses that can be used by importers in Japan:

- . bonded area; this is used by importers who wish to obtain simplified and prompt handling of customs formalities. Goods may be inspected, repacked or sorted and samples put on display, and may only be stored up to 1 month
3. Random Survey of Warehouse Operations. Department of Business and Consumer Affairs. April 1982.
 4. Customs Administration in Japan. Customs and Tariff Bureau, Ministry of Finance. Japan. 1983.

- bonded shed; the bonded shed is similar to the bonded area, however it is established at a place convenient to the importer
- bonded warehouse; the same operations apply as in the bonded area and shed. The goods may be stored for a period up to 2 years
- bonded manufacturing warehouse; permission is given for a place to be used in the processing or manufacturing of any foreign goods. Goods may only be stored for a period up to 2 years.
- bonded display area; goods may be displayed for exhibitions or fairs. Repacking, sorting or inspecting the goods may also be carried out. Goods may also be used in the construction or maintenance of the exhibition.

United States - Free Trade Zones/Warehouse

Foreign or Free Trade Zones were established in the United States in 1934⁵. They complement the bonded warehouses, where a time limit is set for payment of duties on imported goods. Their purpose is to attract and promote international trade and commerce, in particular to under developed areas of the U.S.

Foreign and domestic merchandise permitted in a zone may be stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, otherwise manipulated, destroyed, or manufactured.

Any foreign or domestic merchandise not prohibited by law, whether dutiable or not, may be taken into a zone.

In specific cases permission may be denied to manipulate, manufacture, or exhibit merchandise in a zone in order to protect the public interest, health, or safety.

Many products subject to excise duty may not be manufactured in a zone. No retail trade in foreign merchandise may be conducted in the zone. However, foreign and domestic merchandise may be stored, examined, sampled and exhibited. The Customs Service is responsible for the transfer of merchandise into and out of a zone, the security of goods within the zone, and for matters involving the collection of revenue.

These features are available, in a limited way, under the current Australian warehousing system, eg. manufacturing in bond of telephone equipment.

5. Foreign Trade Zones: U.S. Customs Procedures and Requirements. Department of the Treasury. USA. 1979.

An article on reducing supervision of warehouses in the US is provided at Attachment B. It reports that "after an extensive review of the control of merchandise in bonded warehouses, and pilot tests . . . , Customs opinion was that the system for controlling merchandise should be one requiring annual reporting by the warehouse proprietor with periodic inventories, spot-checks, and audits by customs".

United Kingdom - Credit System/Warehouse

The United Kingdom duty credit system was developed due to a requirement of the European Economic Community⁶. The system has operated since January 1973 and is available in conjunction with the bonded warehousing system and duty paid clearances. A flowchart of the process is provided at Attachment C.

Importers who wish to participate in the duty credit system as opposed to the traditional duty-paid clearances and bonded warehouse systems, must seek a Certificate of Approval from Customs. This application must include a bank guarantee which states the maximum amount of money that can be payable each month on a direct debit system.

Customs has the power to refuse duty credit if the amount payable exceeds the bank guarantee. Similarly, dutiable goods that are found to be undeclared are not eligible for deferment of duty.

Accounts are payable on the 15th day of the month following the entry of the goods or after they have been removed from a warehouse.

Excise duties and duty on imported postal packages are not eligible for duty credit.

The advantage to the importer is in the monthly deferment of duty. Customs have certain security in the amount that can be deferred each month by a particular importer. The duty paid clearance systems still remains available for certain types of clearances and for those importers who do not wish to enter the credit system.

Denmark - Credit System

In Denmark the duty credit system⁶, was implemented after a task force was established to study customs regulations with a goal of modernising the existing methods. A flowchart of the process is provided at Attachment D.

The new draft Customs Act was approved in December 1970, and legislation came into force from April 1971.

6. Unpublished departmental report. Department of Customs and Excise. Australia. 1971.

The duty credit arrangement is available to importers of commercial goods only. Goods imported for private use must be duty paid on collection. Importers wishing to partake in the scheme are registered with Customs and receive a Certificate of Registration.

Payment of Customs duties is in the form of a settlement period. The duties owed in a particular quarter are payable within 1 month and 20 days after the end of the quarter. Excise duties are calculated on a monthly settlement basis and are payable 1 month and 20 days after the end of the month.

Customs is able to collect duties on a regular basis (at least every 4 1/2 months) while the importer has a reasonable period in which duty payment is deferred. Customs officers still have access to spot-checking of goods and premises when the need arises. The ability to sell or re-export without duty payment eliminates importers' money being tied up in duty payment unnecessarily.

The result of this system is that either duty is paid immediately, or duty is deferred but paid within a specified time limit, and goods are entered for home consumption (without Customs controlled warehouses).

It is not known how such a system would relate to a country's quota system, where goods subject to quota may not enter home consumption once that quota has been completely used.

OTHER OPTIONS

General (Public) Warehouse System

Customs does not perceive that abolishing all bonding arrangements, nor restricting the use of bonds to 'time-up' cargo (with an appropriate financial compensation system in its place) as a viable option. This is because of the potentially large cost to the industries serviced by the warehousing system in interest payments on loans for payment of duties, and also in the possible restructuring of production schedules and/or sources of "raw" materials.

Customs, however, sees that a reduction in the number of warehouses as having some merit as an alternative system. This option proposes the abolition of private warehouses, requiring these goods to be stored in general (public) warehouses. They would continue to be operated by private industry. The total number of warehouses for surveillance would be reduced as it is envisaged that it would not be convenient, nor economical, for all private warehouses to convert to general warehouses, becoming open to any company requiring the storage of its imported goods. The cost to industry of not having their own warehouses is not attainable at this time. Suitable criteria would need to be established for granting licences to operate a general warehouse. This will, in turn, assist in determining the number of general warehouses that would eventually be established.

This option would therefore continue to provide the warehousing system required by industry, and would lessen potential adverse reaction to any abolition proposal. It would reduce the cost to the Government of administration, e.g. surveillance, but would also reduce the amount of duty deferred because of a probable decrease in the usage of the warehousing system. Also, it may be expected that the time for which duty would be deferred would be reduced, since many importers would now have to pay the direct cost of storage of their goods. Thus it would enable a more effective administration of the warehousing system.

Immediate Entry System

In considering options to the bonded warehousing system, the complete abolition of the duty deferment system could be seen as an alternative method.

In practice, however, the entry of all goods directly into home consumption, and thus, the payment of all duties without the option of the deferring duty would be costly and, in all probability, damaging to the local importing industry. The advantage the importer has in importing bulk goods, storing, then entering smaller quantities into home consumption in line with production schedules and demand, is the maintenance of a viable business with cashflow regulated as necessary. Any mandatory direct entry system would lead to the importer ordering less and, therefore, losing the cost saving advantage of buying goods in bulk. All additional costs would ultimately be passed on to the consumer.

Payment at Sale of Goods

In contrast to the immediate entry system a method of collecting duties from either the wholesaler, or perhaps the local consumer, rather than the importer, could be considered. This may be effected by establishing a wholesale tax, or sales tax on the goods.

Administrative problems would arise in such a system. The duty collection base would be more diffuse as the importer sells goods to various businesses and individuals, resulting in duty equivalent being paid on perhaps one dutiable item rather than a box or case. It would also involve educating a wider spectrum of the business community to the regulations for payment of this tax and provide wider scope for avoidance. The calculation of duty on goods to be used in manufacturing or building and construction directly by the importer would not prove workable. In addition, the potential for delay in the receipt of revenue is increased at the wholesale point of sale, and even more so, at the retail level.

Generally, any system would prove difficult to implement at both the Customs and Commerce Sector level.

FUTURE DEVELOPMENTS

The rapid advancement of ADP systems over the last 10 years for the purposes of Customs control, coupled with new technology that is developing a duty credit system throughout the commerce sector generally (eg Bankcard, Petrocard etc) suggests that a duty credit system could be used in the collection of certain duties.

Duty credit and electronic funds transfer systems are becoming a recognised alternative system on the international commercial scene. BIS Banking Systems Pty Ltd for example, offer electronic banking using a direct debit system which has recently been adopted by Myer Finance Ltd. In addition Westpac is marketing a system which will be used nationally by Woolworths, BP Australia and Food Plus retail outlets in 1984. Thus, it can be seen that credit systems have the capabilities to be adapted for use by many individuals or by large international corporations.

CONCLUSION

It is felt that more radical options may be obtained if consideration is given to the more fundamental question of protection to the Australian industry. Such options might arise from, for example, the gradual dismantling of the tariff system, with the payment of bounties to domestic manufacturers instead.

However, in the existing economic climate, it is more realistic to consider options that modify and extend the current duty deferment system. This would imply the development of more sophisticated goods control and/or credit systems, involving the use of high technology in a less regulated financial environment.

There will always be delays in revenue receipts when establishing major changes to a system. In this case substantial revenue receipts may be delayed if there is a complete switch to, say, a duty credit system. To minimize the delay in receiving revenues in the change over period it is strongly recommended that the new system be gradually phased in. Consequently, users of parts of the warehousing system being replaced will be transferred into the new system. Permits could be issued on the basis of a revenue risk assessment coupled with a bank guarantee for a cash limit.

The impact on industry, and cost savings to the Government cannot be ascertained without extensive consultation with the industrial, banking and commercial sectors. In addition, as there are financial and taxation policy considerations that need to be taken into account, discussions would need to take place with the appropriate Government authorities, viz. the departments of Finance and Treasury. A reference should, perhaps, be sent to the IAC for a public enquiry into this matter.

Attachment A

HISTORY OF WAREHOUSING ⁷

The Customs Act provides for the Minister to licence premises as Customs Warehouses. Such warehouses provide facilities for the storage of dutiable goods without the necessity for duty to be paid at the time of importation.

Arrangements of this kind have been recognised as important aids to business for hundreds of years. The earliest reference to warehousing appears to be in the reign of Charles I (1625 - 1649). In an effort to increase trade and encourage imports only part of the duties on goods such as silks, linen and tobacco imported into England was demanded on entry; the remainder being secured by bond. It is apparently in this way that the term "bond" became associated with a warehouse.

Licensed Warehousing in its present form began in 1723, due to the need to stimulate trade during the financial distress that followed the "South Sea Bubble". It was confined to tea, coffee, tobacco and wine. However, and despite its success, pressure was applied which led to its eventual abandonment.

The system was again introduced, both in Britain and the Colonies by an Act of 1803. It was under this Act that warehousing was introduced into New South Wales and later into the other Australian colonies.

The Victorian Customs Hand book issued in 1887 shows that, at that time, there were licensed in Melbourne -

- 20 general warehouses,
- 6 private warehouses,
- 6 manufacturing warehouses,
- 28 machinery warehouses,

and at the various outports a further 17, of which 3 were manufacturing bonds. Two Queen's Warehouses were operative at Melbourne and Wodonga, respectively. There were also 7 powder bond licensed throughout the State, and a hulk, "Sydney Griffiths", was licensed as a dynamite bond.

At Federation, warehouses licensed under the various State Customs Act were deemed to be licensed by the Commonwealth under Section 82 of the Customs Act of 1901.

7. Extract from a Customs Training document. Department of Industry and Commerce.

Since Federation the warehousing system has undergone a slow evolutionary process, but few changes have been made to its basic administration. Some notable changes in the recent past have been:

- 1968 - the introduction of Commodity Control methods for examining business records following the trial in petroleum products in 1964,
- 1970 - Weekly settlement for payment of duties introduced,
- 1970/71 - the introduction of ADP systems to control the movement of goods into and out of warehouses. These systems are currently under review to bring them into line with modern technology and accounting processes,
- 1972/73 - the revision and consolidation of a national warehousing policy,
- 1 July 1980 - the review, revision and introduction of legislation covering the current warehouse system. This followed the first major review of the legislation since 1901.

Reducing Supervision of Warehouses

By Joe Palmer



Changing the way we do things is nothing new with Customs. After all, we've been around since 1789 and have had to make many changes in all those years. This is the story of still another change, the end of stationing Customs officers in bonded warehouses.

When the U.S. Customs Service was established in 1789, sailing ships carried all goods moving in international trade. During the 200 years since then, Customs procedures have changed continually, always keeping pace with the changing circumstances of international commerce. Today, those procedures permit Customs to meet challenges posed by cargo arriving by jet planes and container ships, the need to process nearly 300 million persons entering the country each year, and a staggering workload of 4.5 million commercial transactions annually.

Although many changes have taken place, one segment of Customs operations had not changed since the time of sailing ships. This segment was the Customs' bonded warehouse operations.

A Customs bonded warehouse is a building or other secured area in which dutiable goods may be stored for as long as five years, manipulated, or manufactured without payment of duty.

Upon the entry of goods into a bonded warehouse, the importer and warehouse proprietor are subject to liability under their Customs bond. This liability is relieved when the goods are exported, destroyed under Customs supervision, or are withdrawn for consumption in the United States after the payment of duty.

Full accountability has to be maintained for all merchandise entered into a Customs bonded warehouse and merchandise inventoried on a regular basis. The merchandise may, with certain exceptions, be transferred from one bonded warehouse to another.

In the past, Customs controlled bonded warehouse operations by placing a Customs officer in each one. According to an October 1980 Customs Headquarters study, this method of operation cost \$10 million annually. The study said that about \$8.4 million of this cost was in reimbursable charges

Inspector Denise Garman inventories shipments in a bonded warehouse located in Chicago. She is part of the Automated Merchandise Control Unit.

assessed against the warehouse proprietors by Customs, and roughly \$1.6 million was in nonreimbursable costs to Customs. According to the study, this method of operation was determined to require 509 authorized positions (390 reimbursable, 119 nonreimbursable) which represented 3.5 percent of the Customs employment ceiling. The 390 reimbursable positions could not be converted to nonreimbursable positions to fulfill Customs responsibilities in other higher priority areas.

The development of an alternative approach for controlling warehouse operations was not new to Customs. In December 1964, a report titled "An Evaluation of Mission Organization Management," more commonly known as the "Stover Report," commented on the organization and management of the Bureau of Customs and recommended some actions which affected

Reducing Supervision,

continued

warehouse operations. These recommendations were extensively reviewed within Customs following the issuance of the report. However, no action was taken at that time to implement the recommendations.

In a report dated December 16, 1974, issued to the Commissioner of Customs, the General Accounting Office states:

The U.S. Customs Service employs warehouse officers to maintain physical custody of goods in bonded warehouses. We reviewed the necessity of having warehouse officers in view of the inventory document controls maintained at the customhouse and the periodic physical inventories performed by Customs on goods in bonded warehouses. The existing procedures for centrally controlling bonded goods at the customhouse, together with the bond protection of the Customs duties and the periodic physical inventory checks, are adequate for protecting Government revenues without having a warehouse officer present.

After an extensive review of the control of merchandise in bonded warehouses, and pilot tests conducted in Philadelphia and Baltimore, Customs opinion was that the system for controlling merchandise should be changed to one requiring annual reporting by the warehouse proprietor with periodic inventories, spot-checks, and audits by Customs.

The Regulatory Audit Division, in conjunction with the Office of Inspection and Control, developed the audit/inspection program to control Customs bonded warehouse operations. The program provides Customs with a means of effectively controlling its warehouse operations with fewer resources while realizing significant dollar savings for both government and the warehouse community. The cost of the program for fiscal 1983 is projected at \$1 million and is funded completely by the warehouse community.



This cost approximates one-eighth of the charge which was previously billed to warehouse proprietors for reimbursable services provided by Customs warehouse officers under the old program. In addition, Customs has reassigned the administrative nonreimbursable personnel to other projects. The program is unique in that it utilizes postaudit applications and spot-checks to control an operation that once required 100 percent physical supervision. The adoption of this new procedure clearly demonstrates Customs capability to adapt to a modern business environment without increasing risk to the revenue.

Customs feels that the audit-inspection program will provide relief to the private warehouse community by eliminating an extensive cost burden and will provide increased flexibility of operations for warehouse proprietors, since they need not await arrival of Customs officers to conduct supervision. This is a particularly important consideration to the warehouse proprietors if removals must be made on a weekend, holiday, or after normal business hours.

Regional briefings on the new program were held in late November 1982, and the new procedures were implemented on December 1, 1982, with only minor problems. This was evidenced by the spirit of cooperation displayed by the warehouse commu-



Senior Customs Inspector Charles Montgomery inputs data into the computer for a spot check on inventory at a bonded warehouse in Chicago.

nity and the flexibility of Customs personnel at all levels.

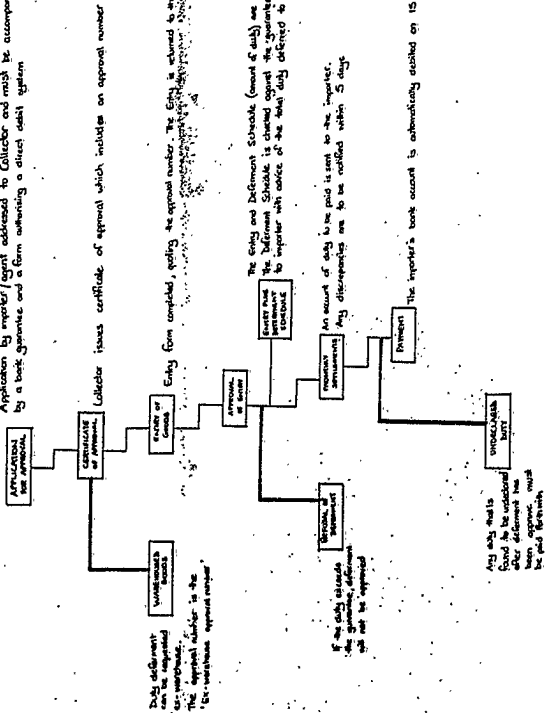
The program, developed through intensive planning and coordination between the Office of Inspection and Regulatory Audit, is a tribute to Customs responsiveness to modern business realities, and it is a genuine success in application. □

Joe Palmer is an auditor in the Regulatory Audit Division.

UK : DEFERMENT OF DUTY

Attachment C

Application by importer/agent addressed to Collector and must be accompanied by a bank guarantee and a form submitting a direct debit system



Attachment E

BIBLIOGRAPHY

Customs Regulations and Procedures in the United Kingdom of Great Britain and Northern Ireland. Her Majesty's Customs and Excise, London, H.M.S.O., 1958.

H.M. Customs and Excise Warehousing Manual. Her Majesty's Customs and Excise, H.M.S.O., 1961.

Her Majesty's Customs and Excise. Sir James Crombie. George Allen & Unwin, 1962.

The Organisation of the English Customs System 1696 - 1786. Elizabeth Hoon. David and Charles. London. 1968.

Customs Administration in Canada; an Essay in Tariff Technology. Gordon Blake. Uni. of Toronto Press. 1957.

Customs Administration in Japan. Customs and Tariff Bureau, Ministry of Finance/Japan International Co-operation Agency. Tokyo. 1980.

"Reducing Supervision of Warehouses" in Customs Today. Spring 1983, pp. 13-14. US Customs Service, Department of the Treasury.

"Foreign Trade Zones: Holding Areas for Importers" in Customs Today. Spring 1980, pp. 19-21. US Customs Service, Department of the Treasury.

Collection of Yugoslav Laws. Institute of Comparative Law.

Small Windows with Iron Bars. UK Customs Booklet.

Random Survey of Warehouse Operations. Department of Business and Consumer Affairs. April 1982.

Management Review of Inland Services. Department of Business and Consumer Affairs. September 1978.

Report of the Working Party on Warehouse Entries. Department of Business and Consumer Affairs. November 1980.

IAC Annual Report 1981/82. Chapter 3. A.G.P.S.

IAC Report - Wood and Articles of Wood. A.G.P.S. 1981.

Auditor-General's Reports for 1980/81 and March 1982 on the Department of Business and Consumer Affairs.

Report of the Auditor-General on an Efficiency Audit. The Collection of Excise Duties and Deferred Customs Duties by the Department of Business and Consumer Affairs. Efficiency Audit Report No. 4. A.G.P.S. March 1982.

Customs Act 1901.

Customs and Excise Revenue, Australia, July 1983. ABS Catalogue No. 5425.0. November 1983.

BANKSMEADOW PIPELINE METERING SYSTEM

Material provided by CALTEX OIL (Australia) Pty Ltd in
May 1984

BANKSMEADOW PIPELINE METERING SYSTEM

Initially installed for environmental purposes - i.e. leak detection by comparing meters at each end of the line with each other which was a pipeline licence requirement. Subsequently as the line was carrying product under bond, the meters were used for custody transfer purposes.

The whole pipeline system is controlled from the Banksmeadow control centre which carries out three functions :-

- (1) Distributes product.
- (2) Monitors line for leak detection.
- (3) Measures and records product transferred.

To carry out these functions, it requires two computers with hardware/software cost in excess of \$2,000,000 and 6 trained Operators on continuous shift work.

The metering instrumentation situated at the rear of Banksmeadow terminal costs in excess of \$500,000 and the annual maintenance budget for metering instrumentation and software auditing is in the order of \$75,000 p.a. out of a total repair budget of \$200,000 for the BMT pump station.

The pipeline system has 5 such metering systems.

For product measurement, the pipeline system investment in measurement instrumentation and software is in the order of \$4,000,000. NOTE : This is for a single pipeline system.

Caltex was fortunate that this system was available in close proximity to the main product lines from Kurnell to Banksmeadow.

Meters were placed in these lines (A&C lines) utilising the majority of instrumentation and software already available. Had this not been available, Caltex couldn't have justified meterisation of A&C lines.

Operating Data of the Product Measurement System

Meter accuracy guaranteed by manufacturer is 0.15% with a repeatability of 0.02%. Taking instrumentation error into account, accuracy tolerance is 0.25%.

Provers are check calibrated yearly by NATA approved contractor using certified calibrated instrumentation. Provers are used to calculate correction factors for meters under varying condition of flow and varying temperature, density and pressure of products.

Temperature, density and pressure instrumentation check calibrated at least half yearly with an annual instrumentation audit.

Meters in line transmit "gross" flow figures to the central processors. With temperature, density and pressure figures picked up at the metering point the CPU's carry out a gross to nett conversion, utilizing API source equations rather than API tables derived from the equation.

In addition to the gross to nett conversion, an adjustment is made for differing performances of the meter.

Meters "measure" differently for differing product, viscosities flow rates, pressures, temperatures etc. by "proving" the meters for variation in these factors, an actual factor for operating condition at the time is applied.

Actual Operating Results

Between August 1983 (commencement of operation of Shell Clyde pumping product into the system) to March 1984, the pipeline system handled 131,851,290 litres of petroleum products sourced from 2 refineries and delivered to 3 offtake points through meters, the difference between receipts and deliveries was 285,700 Litres, ie. a difference of 0.21%.

A trial between Kurnell dips A&C lines meters and Botany offtakers for the first quarter of 1984 revealed the following results :-

<u>AOR Dips</u>	<u>BMT A&C Meters</u>	<u>Receivers Dips</u>
344,235,650	343,962,140	344,168,710
	<u>Loss</u>	<u>Gain</u>
	0.08%	0.06%

indicating that the A&C lines are operating as designed and are ready to be utilised for custody transfer purposes.