

Chair's Text for INB-3

Internet Sales, Duty Free Sales and Free Trade Zones

1. This briefing reviews Article 10 of the current Chair's text for an Illicit Trade Protocol, relating to internet sales, and Article 11, relating to free trade areas and duty-free sales.

Internet Sales

2. The current Chair's text proposes two alternative drafts for Article 10.
3. The first version would require that any enterprise based in a Party and involved through the internet, telecommunications-based systems or similar means, in commercial sales, manufacture, distribution, storage, shipment, import or export of tobacco products or manufacturing equipment would have to meet all the relevant obligations of the protocol. This would imply, for example, that internet sales from sites based in any Party would have to comply with the tracking and tracing requirements set out in Article 7.
4. The second version would require all Parties to the protocol to ban sales of tobacco products and manufacturing equipment through the internet, telecommunications-based methods and through any other similar technologies that may be developed.
5. Internet sales contribute to the international problem of illicit trade. There is a clear incentive to try to sell in this manner from low tax jurisdictions into higher tax jurisdictions. For example, internet sites aimed at european customers are numerous (some may have fraudulent intent). One example is euro.cigoutlet.net, which offers sales to "Austria, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom" and states that "the cigarettes are sent to Europe by divided cartons, i.e. 2 or 5 packs into each package... European customers are often imposed to pay taxes by Customs authorities when the cigarettes are delivered. When it happens customers prefer to refuse the parcel and it is sent back to us. In such cases we guarantee a refund and for all this our company incurs losses. However it is still cheaper to buy our cigarettes rather than those in local stores." The site states that "we don't report tax or customer information to any government agency or other entity".
6. Remote means of retail sale can allow someone in one country to buy tobacco from someone in another country, without the knowledge of anyone other than those arranging payment for the transaction and delivering the goods (and they will often be unaware of the nature of the items they are delivering). Payment of taxes and duties in these circumstances is obviously difficult to monitor. For

example, different delivery services can deliver multiple consignments of products to either the same individual at the same address or multiple individuals at different addresses, without authorities observing any unusual or suspicious activity.

7. Broadly speaking, the FCA supports the approach in the second version of the article. The internet is already a significant mode for sales of tobacco products, However, FCA also wants the relevant articles in the protocol to cover all remote means of sale to retail customers, not merely sale through the internet. Genuine business to business sales would not be covered by these provisions.
8. Enforcement methods for a ban on Internet sales should include:
 - Action in relation to credit card companies and online payment systems based in any Party to the protocol to ensure that they do not service sites offering tobacco products for retail sale;
 - Action to prohibit the transport or delivery of tobacco products sold through such sites and through other remote means, by making it unlawful to knowingly send or deliver tobacco products to retail customers through postal, courier and other delivery systems.
9. FCA considers that the current text of Article 10 needs redrafting to ensure that its objectives are met in practice. A revised suggested draft is given in our side by side text attached to this Brief.

Free Trade Areas/Zones

10. Article 11 of the current Chair's text seeks to prohibit any tax and other regulatory advantages that may exist in "*free trade areas*" from applying to tobacco products, including tax reduced and duty free sales.
11. FCA would support the intent of this provision, but we believe it needs to be both clarified and strengthened.
12. The term "*free trade area*" is the wrong term to use in this context, since it would appear to cover a wide range of cases up to and including international free trade areas such as NAFTA, MERCOSUR and the European Union. It is not a practical objective for the protocol to seek to ban all movements of tobacco products within such areas from one country with relatively low prices to another with relatively higher prices, for example when purchased by consumers for individual use.
13. The term "*free trade zone*" would seem more appropriate, as applied to areas within countries, where special rules on tariffs, quotas and regulations may be applied.

Duty Free Sales

14. The provisions in the draft article relating to tax reduced and duty-free sales also need to be strengthened, since the current draft appears only to relate to such sales within free trade “areas” and not to regular duty-free sales at airports, ports, land border crossings and on ships and airplanes.
15. There is clear evidence that legal duty-free sales can be a means whereby tax-exempt product supposedly intended for duty-free stores is diverted into illicit trade. This is acknowledged even by tobacco multinationals such as BAT.ⁱ Cigarettes marked for duty-free sale may end up as contraband continents away. FCA members have evidence of such sales from stores or street vendors in, for example, the Philippines, Egypt, Iran, Pakistan, India and Dominican Republic, for example. In some countries, supposed “duty-free” cigarettes are a major source of contraband volume.
16. However, both the tobacco industry and trade associations involved in duty free sales have been heavily engaged in the run-up to INB 3 in attempting to prevent progress towards ending such sales.ⁱⁱ



Cigarette package with South Korean warnings, marked for duty-free sale in South Korea, but sold by a street vendor in Mumbai, India, March 2009

17. The case for a ban on duty-free sales has been strengthened by growing government and international action on the issue. Recent steps include:
 - Indonesia has shut down arrival duty-free stores from April 2009
 - India's Health Minister called for a ban on duty-free sales of tobacco products in India in November 2008
 - Bulgaria and Romania banned duty-free sales at land borders with non-EU countries in 2008, to combat a major known source of illicit trade
 - Nepal banned duty-free sales at Kathmandu airport in 2008
 - Canada since 2001 has imposed federal tobacco tax for sales in “duty-free” stores, although not provincial tobacco tax
 - A ban in the European Union since 1999 on duty-free sales to individuals traveling within the EU.

18. In addition to reducing illicit trade, a ban on duty-free sales would also:
- Increase Government revenue, by eliminating untaxed sales
 - Reduce the ability of the tobacco industry to associate tobacco with luxury goods and International travel, and to use duty-free stores as marketing venues
 - Help reduce the social acceptability of tobacco products
 - End a source for relatively inexpensive tobacco products: lower prices increase consumption.

Conclusions

19. FCA therefore considers that draft Article 11 should be divided into two separate articles, one addressing free-trade zones and one addressing duty-free sales. All duty-free, duty-reduced, tax-free and tax-reduced sales should be addressed, not only sales occurring in free trade zones. All tax-and duty-free and tax- and duty-reduced products are at risk of diversion into illicit trade channels, not only those sold within free-trade zones.
20. The provision dealing with free-trade zones should explicitly prohibit the introduction of tobacco, tobacco products and manufacturing equipment used in the manufacture of tobacco products into these areas. As it would not be possible for tobacco, tobacco products or manufacturing equipment to be introduced into a free-trade zone without enjoying at least some *'tax, regulatory or other advantages'* that apply in the free-trade zone, FCA in fact understands this to be the intention of the draft Article. However, for the avoidance of doubt, this should be explicitly stated. FCA recommends the inclusion of exceptions to this prohibition for tobacco or tobacco products introduced into a free-trade zone for personal consumption or for sale to persons ordinarily present in the free-trade zone, provided that any ordinarily applicable taxes, duties or other charges are applied.
21. The provision dealing with duty-free sales should apply to 'tax-free' sales, as well as 'tax-reduced' sales, and to 'duty-reduced' sales, as well as 'duty-free' sales. FCA recommends that the prohibition apply to sales to 'international travellers' rather than 'individual customers', as prohibition of all tax- and duty-free and tax- and duty-reduced sales within a Party's territory, including, for example, sales in native reservations and on military bases, may not be practicable in all Parties.
22. A redraft of Articles 10 and 11, designed to achieve the objectives set out in this briefing, are included in the attached side by side comments on the Chair's text.

ⁱ British American Tobacco, "British American Tobacco's views on duty free in the FCTC Protocol, April 2009.

ⁱⁱ See for example www.aci-europe-events.com/airport-trading-conference/