



# **Study on Council Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco**

Executive Summary

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## EXECUTIVE SUMMARY

### 1. Overview of the Study

The purpose of this Study is to provide a comprehensive and evidence-based **evaluation of Council Directive 2011/64/EU** (the 'Directive') on the structure and rates of excise duty applied to manufactured tobacco. It consists of two Volumes: (1) a retrospective evaluation of the performance of the Directive against its stated objectives, and (2) a forward-looking impact analysis involving the assessment and the comparison of different measures to address a set of policy issues identified, including the 'no EU action' scenario. A baseline analysis of market structures, demand and tax policies in the different EU Member States and of their recent trends is also provided.

The Study features a **quantitative analysis** of the demand for tobacco products in the Union and the related effects of taxation *vis-à-vis* other factors. On a **qualitative** level, the analysis is supported by the results of targeted consultations and interviews with key informants - including *inter alia* tax and public health authorities of the Member States, representatives of tobacco and electronic cigarettes industries, public health academic experts and associations - as well as the results of an open public consultation. The timeframe of the analysis is the 2011-17 period; the geographical coverage is the EU 28 with no specific deep dives into individual countries.

The results of the Study contribute to clarify how fiscal policies, and more specifically the provisions of the EU tobacco excise legislation, influence the price levels and the affordability of tobacco products and, in turn, the level of the demand, the consumer substitution behaviour, cross-border 'shopping' and illicit trade patterns, and the tax revenues of the Member States. The Study also reviews and updates the conclusions of previous Commission studies on the impact of harmonising at EU level the tax treatment of **electronic cigarettes** and **heated tobacco products**, comparing the effects of different possible courses of action.

### 2. Background and context

In line with the previous EU excise legislation on tobacco, Directive 2011/64/EU aims at harmonising the excise duty regimes of Member States, with the twofold purpose of ensuring a **proper functioning of the internal market** and, at the same time, a **high level of health protection**. These two overarching objectives respond to different and not entirely aligned needs, i.e.: to extend the freedoms and principles of the Single Market to the manufactured tobacco sector, and at the same time, restrain and discourage its consumption for public health reasons. In these respects, the Directive acts in synergy with (and is expected to contribute to) various other policy instruments, in particular: Directive 2014/40 (the 'Tobacco Product Directive - TPD2'), Directive 2008/118 (on the general arrangements for excise duty), the EU strategy to fight against the illicit tobacco trade (COM(2013) 324), and the WHO Framework Convention on Tobacco Control (FCTC).

The policy instruments laid down in the Directive to achieve its objectives are of three main types:

- 1) the **definition of common tax categories** for manufactured tobacco subjected to excise duty: (a) cigarettes; (b) cigars and cigarillos and (c) smoking tobacco - further subdivided into fine-cut tobacco (FCT) and other smoking tobacco;
- 2) provisions to **harmonise excise structures** and in particular: (1) the 'mixed structure' requirement for cigarettes, i.e. the obligation to levy both a specific and an *ad valorem* excise duty; and (2) the possibility to levy a 'minimum excise duty';

- 3) the **establishment of minimum excise rates** (the 'EU minima') for all categories of products, which for cigarettes include both a monetary minimum and a price-related minimum (which Member States can derogate from when tax rates exceed a certain level). For the other products it is sufficient that either of the two 'minima' conditions is fulfilled. Nine Member States were granted a **transitional period** to reach the prescribed EU minima for cigarettes, which expired at the end of 2017.

### 3. Summary of key findings

#### 3.1 Functioning of the internal market

The need to ensure a proper functioning of the internal market is frequently reiterated in the preliminary statements of the Directive, which makes this objective the primary subject of the evaluation. According to the Directive itself, this objective presupposes that the application of taxes does not distort the **conditions of competition** and does not impede the **free movement** of these products within the Union, as well as the **free formation of prices**. More specifically, the differences in excise (hence price) levels between countries, especially for cigarettes, are seen as possible distortive factors – possibly encouraging also **fraud and smuggling** – so there is an explicit need to support **convergence** in such levels. The Directive also calls for reducing the tax gap between cigarettes and fine-cut tobacco on account of the **substitution** effect that it may enable. Although not explicitly mentioned in the provisions, there is also a need to ensure an **efficient excise collection** in Member States. The concrete results achieved by the Directive have therefore been evaluated against these specific objectives and taking into account the policy instruments actually deployed. The outcome of the analysis can be summarised as in the following paragraphs.

#### ➤ REDUCE TAX AND PRICE DIFFERENCES BETWEEN MEMBER STATES

One of the main objectives of the minimum rates laid down in the Directive was to **reduce the disparities** in tax (hence price<sup>1</sup>) levels between Member States to prevent the risk of distortive effects on the functioning of the internal market potentially caused by excessive price differentials. The actual achievements in this area have been mixed. In fact, the gap between 'high-tax' and 'low-tax' countries has slightly expanded, although EU minima have seemingly contributed to mitigating such trend. The effectiveness of EU minima has, however, declined overtime because the periodical increases were insufficient to cope with price level and income growth.

One of the main effects of price differentials between Member States consists in the so-called 'cross-border shopping', i.e. the **cross-border flows** of legal (tax-compliant) products from low-price countries to high-price ones. In 2010, the total flows of cigarettes duty-paid in another EU country amounted to an estimated overall 32.0 billion pieces, of which some 23.2 billion were possibly driven by an economic advantage – i.e. a significant price difference between the country of origin and the country of destination. The estimated economic-driven cross-border flows have reduced by 1.0 billion between 2010 and 2016, but its share on the total sales of cigarettes in the EU has increased from 3.8% to 4.6%. So, in the period considered, the consumers' reliance on cigarettes sourced from lower-price countries has rather increased than declined in relative terms. At the EU aggregated level, the magnitude of flows is limited, but in certain Member States it can cause significant tobacco control and tax revenue issues. For instance, in the period examined the average net inflows of cigarettes from other EU countries to Germany, France, Austria, Ireland and Netherlands exceeded 10% of the estimated total domestic consumption; conversely the net outflows of Luxembourg,

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<sup>1</sup> The focus on the Directive is on tax rates and not on prices, but it is nonetheless acknowledged that '*the level of taxation is major factor in the price of tobacco products*' (Recital 16).

Czech Republic, Poland, Slovenia and Estonia, have been 15% greater than the total cigarettes released for consumption there. The estimated foregone tax revenues in countries with a net 'inflow' of cigarettes have amount to ca. EUR 6.0 billion annually.

#### ➤ **PREVENT AND ADDRESS TAX-INDUCED SUBSTITUTION BETWEEN PRODUCTS**

Another specific objective of the Directive was to contribute to bridging the 'tax gap' between cigarettes and fine-cut tobacco (FCT) in order to prevent and mitigate **tax-induced substitution**. In this case, the policy objective was not only to avoid competitive distortions but also to take into account the 'equally harmful character' of the two products. The econometric analysis carried out has confirmed the existence of a robust inverse correlation between the demand for these products and the respective price levels. In line with this, the narrowing of price levels that occurred in recent years<sup>2</sup> has significantly reduced the magnitude of tax-driven substitution, which has fallen from an estimated 7% of total consumption in the 2009-13 period to some 2% in the 2013-17 period. In fact, the demand for FCT has been on the rise until 2012 and plateaued thereafter (between 85 and 90 million Kg / year), whereas the sales of cigarettes have kept falling, down from 606 billion pieces in 2010 to ca. 475 billion in 2017, but at a slower pace after 2014.

The contribution provided by the Directive to this process has been mixed. Only three countries (Bulgaria, Croatia and Luxembourg) have occasionally needed to adjust their FCT tax rates to meet EU minima requirements, while in most cases tax hikes seemed primarily driven by Member States' own policy needs, although likely influenced by the Directive's objectives. It should be added that the Directive provisions were not entirely coherent with this objective, as the trajectories of EU monetary minima set for cigarettes and FCT were not always converging. In perspective, the issue of substitution is going to be less critical than in the past, but it is nonetheless important to maintain the trend of reduction in the tax gap between FCT and cigarettes.

The level of taxation of other tobacco products, like **cigars, cigarillos and other smoking tobacco**, was not subjected to any specific policy objective in the Directive, beside the overall need to establish minimum rates for the sake of better internal market functioning. In the past, too flexible product definitions had enabled the proliferation of so-called 'borderline' cigarillos in some Member States (e.g. Germany, Hungary, Spain, Denmark and Baltic countries),<sup>3</sup> but this issue was effectively addressed by revising the definition (and phasing out the derogation extended in this respect to Germany and Hungary) and by increasing the taxation of low-price products in the concerned countries. Altogether, cigars, cigarillos and other smoking tobacco account for only 3.5% of the expenditure on smoking tobacco in the EU (ranging from as low as 1% to less than 9% at country level) and this percentage has been declining steadily overtime (except for water-pipe tobacco), so they do not represent at the moment a problematic policy area. Still, the EU minima for these products have not changed for many years and have therefore become irrelevant for almost all Member States.

#### ➤ **THE HARMONISATION OF EXCISE STRUCTURES**

To ensure fair competition in the Single Market, the Directive also envisages progressive **harmonisation of excise duty structures** across Member States. In particular, it prescribes for cigarettes the adoption of a 'mixed structure' - inclusive of a specific and an *ad valorem* excise component - and mandatory lower and upper thresholds for the

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<sup>2</sup> The EU weighed average FCT / cigarette price ratio has grown from 46% in 2010 to 57% in 2017 (assuming a 0.75g=1 stick equivalence).

<sup>3</sup> The matter has been examined in greater details in the EA 2018 study.

incidence of the specific component on the total tax burden, which are set to converge overtime.<sup>4</sup> However, despite these measures being in place since the earliest versions of the Directive, little progress has been achieved so far: the permitted band remains so wide (i.e. from 7.5% to 76.5%) that nearly fully specific or *ad valorem* regimes are *de facto* allowed, and only a minor step towards greater harmonisation was taken in the 2011-17 period (bringing the lower threshold from 5% to 7.5%). On the other hand, this limited progress **has not caused concrete policy problems** for two reasons: (1) structures have nonetheless converged as a consequence of Member States own policies; (2) the subsequent adoption of EU minima has enhanced the overall EU-wide harmonisation process, making the 'mixed structure' requirement rather redundant.

Nearly all Member States apply a '**minimum excise duty**' (**MED**). This voluntary measure consists in a tax 'floor' that Member States can apply when the sum of the specific and *ad valorem* excise yield falls below a certain monetary amount, with a view to prevent 'price wars' and the related adverse effects for both tax revenues and tobacco control targets. The results of the analysis showed that the MED has been the single most effective component of excise taxation as regards the impact on price levels. In particular, it has contributed to sustained 'entry price' levels overtime, thus reducing the accessibility of tobacco products. There is no (longer) a ceiling to the MED, but there is an obligation to respect the 'mixed structure' requirements, which can be seen a *de facto* limit to the MED level permitted. However, this provision is interpreted differently between MS leading to non-uniform views and practices concerning the upper limit of the MED. In a previous Report, the Commission recognised the discrepancy in the interpretation of MED provisions as potentially distortive for the functioning of the internal market.<sup>5</sup> The consultation of tax authorities confirmed the existence of legal uncertainties with this provision and the **demand for clarifications** to remove the current disparities of implementation while preserving the overall flexibility of this mechanism.

#### ➤ **PRE-EMPT TAX FRAUD AND SMUGGLING**

The illicit trade of tobacco products is a multifaceted problem that, as acknowledged in the Council conclusions of December 2017, can have negative financial impact on the budget of the EU and the Member States, as well as considerable adverse impact on health protection and the rule of law.<sup>6</sup> There is a notoriously **lack of comprehensive and reliable data** on this phenomenon – a gap that is recognised by the Council and is being addressed by the Commission through the development of *ad hoc* measurement methodologies.<sup>7</sup> The bulk of the problem is represented by **illegal cigarettes**, which are primarily sourced from third countries (especially the so-called 'illicit whites'), but national authorities feedback indicate that are also increasingly manufactured within the EU. Based on the available estimates, in the 2010-16 period the annual volume of illegal cigarettes amounted to 45-50 billion pieces, representing some 7%-8% of the total consumption.<sup>8</sup> In absolute terms, the magnitude of illicit trade has likely slightly declined, but its share on total consumption has conversely registered a small increase (ca. 0.5%). The magnitude of the problem greatly varies between EU countries. The most affected ones include: (1) countries more exposed to flows from non-EU countries, like Poland, Romania, Bulgaria, Greece and the Baltic Countries; and (2) Western EU

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<sup>4</sup> The Directive envisages that in the 'final stage' of the harmonisation the same ratio shall apply in all Member States.

<sup>5</sup> COM(2015) 621, Report from the Commission to the Council on the REFIT evaluation of Directive 2011/64/EU and on the structure and rates of excise duty applied to manufactured tobacco, 2015.

<sup>6</sup> Council conclusions on stepping up the fight against illegally traded tobacco products in the EU (7.12.2017).

<sup>7</sup> In particular, OLAF has commissioned an external study on this matter, which is ongoing at the time of the preparation of this Study.

<sup>8</sup> These figures do not include the abovementioned cross-border flows of cigarettes duty-paid in another Member States, which can include both products for legitimate own consumptions as well as products for illicit reselling.



countries with high price levels, such as France, the UK, Ireland and Nordic countries. In the period examined, the EU-aggregated **tax revenue loss** associated to illicit trade amounts to nearly EUR 7.5 billion / year on average<sup>9</sup>, with an incidence that in certain countries may account for 20% of tax receipts collected.

The information on the illicit trade of **products other than cigarettes** is even scantier, but several tax authorities, industry and public health stakeholders agree that it is on the rise. According to some industry-commissioned studies, illicit cut tobacco sold in bulk<sup>10</sup> would amount to some 8,000 tonnes year in Eastern EU countries and in excess of 18,000 tonnes/year in Western EU countries, but these estimates have to be taken with due caution. Nonetheless, it remains that the seizures of illicit bulk tobacco have steadily increased overtime, hitting some 2,400 tonnes in 2015. In the case of water-pipe tobacco, the illicit market has been estimated at roughly 2,500 tonnes in 2016, representing some 50% of the total estimated consumption.

The results of the Study indicate that the demand for illegal cigarettes is elastic to price trends and even more strongly to income trends. So, any tax increase that leads to a substantial reduction of affordability may **unintendedly foster the demand** for illegal products, but the extent of the impact depends also on other country-specific factors such as geographical position, the control and enforcement capacity, social acceptability of illegal products etc. So, in the period considered, EU minima could have contributed fuelling illicit trade from across the EU external border into some Eastern EU countries, although the estimated magnitude of direct effects is small. Recent policy developments that are worth mentioning in this area include the entry into force in 2019 of the 'track-and-trace' system.<sup>11</sup>

### 3.2 Protection of public health

According to *Eurobarometer* data, the **smoking prevalence** in the EU has declined from 29% to 26% between the end of 2009 and 2017, which means that the number of regular smokers has reduced from roughly 117 million to 103 million.<sup>12</sup> There remain substantial differences between countries and population groups. In some Member States (e.g. Bulgaria, Greece) smokers still represent more than 35% of the population, while in others (e.g. Sweden, Denmark, Belgium, Ireland and the UK) prevalence is currently well below 20%. Furthermore, while prevalence has declined in most Member States, in some of them it has remained stable or even increased (e.g. in Czech Republic, Portugal, and Slovenia). Female-smoking emerges as a specific EU problem as compared to other world's regions: in some EU countries prevalence among women is higher than among men and/or has been decreasing at a slower pace. Smoking prevalence among the youth (15-24 years old) has generally declined as compared to 2009 levels, although since 2014 such trend has apparently plateaued and even reversed in a few countries.

The **affordability** of cigarettes and fine-cut tobacco has decreased in most EU countries over the last decade, contributing to the decline of the smoking prevalence registered in the region. The increase in the price index of tobacco was primarily driven by tax hikes, and in this sense the analysis showed a certain degree of additionality from the EU minima in helping decrease consumption. However, the contribution was of moderate magnitude and limited to a few 'low-tax' countries. Moreover, it has arguably reduced overtime as the number of Member States falling below the EU minima has been

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<sup>9</sup> This estimate does not include the cross-border purchase of tax compliant cigarettes for illicit reselling or otherwise infringing the provisions of Art. 32 of Directive 2008/118 on acquisition by private individuals for own use.

<sup>10</sup> 'Illicit cut tobacco' refers to partly processed tobacco diverted to tax-evaded retail selling to final consumers and/or illegal manufacturing.

<sup>11</sup> Implementing Articles 15 and 16 of Directive 2014/40.

<sup>12</sup> Other sources - namely Eurostat (EHIS survey), the WHO, and Member States sources - provide different estimates but generally confirm the downward trend.

shrinking. As the Study showed, other non-economic factors have significantly contributed to the decline of smoking prevalence including the so-called 'de-normalisation' of smoking and the downslope of the so-called 'tobacco epidemics' in various EU countries.

A relative majority of public health authorities of the Member States recognised that the Directive had a positive contribution to tobacco control objectives, albeit not always up to expectations. In perspective, there is a **strong demand for an upward revision of EU minima**, including a further reduction of the tax gap between cigarettes and FCT.

### 3.3 The status of heated tobacco products and electronic cigarettes

One of the dimensions where the EU excise legislation is clearly not responsive to Member States needs and demands regards the **unclear status of heated tobacco products (HTP) and e-cigarettes**. These products are not explicitly covered by the Directive since they appeared on the market in more recent years, but they fall into the scope of the more recent Directive 2014/40 on tobacco products and are increasingly discussed at the international level, including within the FCTC Conference of Parties. In absolute terms, the market of these products is still small as compared to conventional tobacco, but the growth in investments and consumption registered in the past few years suggests they are unlikely a transitory phenomenon. In particular, e-cigarettes consumers have doubled between 2013 and 2017 from ca. 6 to more than 12 million regular users, while HTP – whose large-scale commercialisation started only in 2016 – has reached 1.3 million consumers as of mid-2018.

The relatively rapid uptake of these products has prompted several Member States to adopt *ad hoc* fiscal measures in their domestic legislations that had the side-effect of causing a **substantial fragmentation of the EU internal market** and various adverse effects downstream, including obstacles and competitiveness disparities for businesses, administrative burdens for Member States authorities, and the spreading of various tax avoidance practices challenging the enforcement and control of tax measures themselves. In the case of HTP, thirteen Member States have introduced a non-harmonised category in their legislation - with differences in structures and rates<sup>13</sup> - whereas other ten countries opted for subsuming HTP in the existing 'other smoking tobacco' category, primarily to ensure that these products are moved under the *Excise Movement and Control System*. As concerns e-cigarettes, thirteen Member States have adopted an *ad hoc* non-harmonised tax. This is generally a specific tax per volume of products but while half of countries apply it only to nicotine-containing liquids, the other half apply it to any liquid for consumption in an e-cigarette device.<sup>14</sup> For both categories of products, the main justification underpinning *ad hoc* taxes concerns market functioning and control, including the need to prevent tax-induced substitution with conventional products and related loss of tax revenues. Instead, the perceived public health profile of these products was seldom behind Member States decisions whether to tax them or not.<sup>15</sup> This appears in line with the diverging opinions that still characterise the debate among public health stakeholders, including at the WHO FCTC level<sup>16</sup>, due to the lack of definitive statements on the impact of these products on smoking cessation and harm reduction or, conversely, on the health risk that they may constitute for adolescents and young adults.

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<sup>13</sup> For instance, ten countries tax HTP by weight, except Italy and Hungary who tax it by unit (stick) and Portugal who has a mixed specific and ad valorem regime in place. Rates vary from nil (temporarily in place in Poland and Czech Republic) to in excess of EUR 200 per Kg (equivalent) in Italy.

<sup>14</sup> Other exceptions are Latvia, where the tax includes both a 'per volume' and a 'per nicotine concentration' component, and Croatia who apply a zero rate.

<sup>15</sup> As concerns e-cigarettes, this is the least frequently mentioned reason for taxing (important in only three countries) or for non-taxing (only one country is against taxation based on reduced risk considerations. For HTP, only four countries mentioned its less harmful character as a relevant fiscal argument.

<sup>16</sup> At the latest FCTC Conference of Parties (October 2018) it was raised the need to carry out an independent wide-scope research on the public health impacts of HTP and, possibly, a monograph on e-cigarettes.

Irrespective of their legal frameworks, the vast majority of Member States is in favour of the **adoption of a common EU fiscal policy** for these products, to overcome the current legal and administrative disparities and in line with the Directive's objective of fostering the integration of the EU market. This attitude prevails also among the public health authorities consulted, while it is largely opposed by the e-cigarettes industry – with the partial exception of operators from countries where an *ad hoc* tax on e-cigarettes is already in place – and by users.

## 4. Recommendations<sup>17</sup>

### 4.1 Revision of current EU minima

In the absence of a revision of the current EU minima the differences in price levels between Member States would likely increase, with the risk of exacerbating the situation in countries that are currently affected by high-magnitude cross-border flows. Furthermore, the contribution of the EU excise legislation to public health objectives would further reduce overtime. It is therefore recommended to increase **the current EU minima on all tobacco products**, and particularly the fixed amount provisions (i.e. the monetary minimum, and the so-called 'escape clause' thresholds), which have more markedly lost their relevance and effectiveness overtime, due to inflation and income growth. The following criteria could possibly guide the setting of the new rates:

- (1) the planned increase should be greater than the expected inflation and income growth, otherwise there would be no impact on affordability;
- (2) the extent of the tax increase should be fixed having considered also the price affordability, in real terms, in the different Member States, and the risk of fuelling illicit trade in countries more exposed to it for geographical reasons;
- (3) regular increases of minima overtime should be envisaged to cope with inflation and income growth; such increases should be enacted at the same time for all categories of products;
- (4) the EU minima of cigarettes and FCT should continue converging, whereas for the other less problematic products it is suggested that the original 'tax gap' with cigarettes is firstly restored to the level it had in 2010, then at least maintained overtime;
- (5) a hypothetical revision of the current rules and mechanisms of application of minima to the different products is not advisable since it would cause regulatory burden and provide limited added-value.

In general, it is worth highlighting once again that revised EU minima would contribute to but cannot entirely solve the policy problems identified, and that other measures outside of the scope of the Directive should also be considered, including at the national level. These primarily regard tobacco control policies and measures to fight illicit trade, such as the upcoming 'track and trace' system and cooperation with non-EU countries towards a reduction of tax differentials, and the possible review of the provisions concerning the cross-border movement of products acquired by private individuals.<sup>18</sup> which are currently being examined by the Commission.

### 4.2 Harmonisation of tax regimes for heated tobacco products and electronic cigarettes

If no action is taken at the EU level, it can be predicted that the fragmentation of national fiscal policies for heated tobacco products and electronic cigarettes, and therefore of the

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<sup>17</sup> The detailed impact analysis supporting these recommendations is the subject of Volume 2 of the Study.

<sup>18</sup> Reference is made to Art. 32 of Directive 2008/118 that is currently the subject of an external study commissioned by DG TAXUD.

EU internal market, could worsen in the coming years, along with the expected growth of the demand and the diversification of products. Therefore, despite the persisting lack of systematic information and consensus on relevant aspects such as consumption patterns, profile of users, actual impact on smoking prevalence and possible harmful effects, it can be still **recommended to proceed to a fiscal harmonisation of these products at EU level**. Specifically, such EU-level harmonisation should focus on enabling proper market monitoring and control, smooth functioning of the excise systems and the removal, to the extent possible, of tax-driven competition issues. Instead it should not directly aim at influencing the switchover of consumers from conventional tobacco products, leaving Member States substantially free to adopt the most appropriate policies in this respect, based on the specificities of their markets and consumers behaviours.

As regards the harmonisation of **heated tobacco products** (HTP), it is recommended the establishment of a new tax category rather than fitting them into one of the existing ones, so as to disentangle the regime applied to HTP from that of other conventional products and allow a more granular monitoring. In line with the prevailing approach in Member States, a 'per weight' specific structure seems more flexible and possibly future-proof than a 'per unit' one, but the matter can also be deferred to secondary legislation to facilitate the adaptation of parameters to market evolution. Minimum rates should be set taking into account that the unit-weight of HTP is currently lower than for any other conventional tobacco product. The benefits of harmonisation would regard primarily smoother cross-border movements and better control (through the *Excise Movement and Control System*) and a reduction of the current administrative burden caused by the disparity of approaches between countries. On the other hand, some one-off investments would be necessary to update tax administrations' systems. These costs were not quantifiable but were generally seen as non-problematic by tax authorities themselves. Since these products are currently traded by a few manufacturers only, the costs of collecting taxes and the risk of fraud are limited.

The introduction of a harmonised tax regime for **e-cigarettes** is more controversial due to its predicted mixed effects. On one side, the removal of country-level disparities will likely lead to a greater market integration at EU level and to levelled conditions of competition between operators from different countries. But on the other side, a substantial taxation would encourage illicit trade and the practice of self-mixing products by consumers (so-called 'do-it-yourself') as happened for instance in forerunner taxing countries like Italy, Portugal and Romania. Such impacts would be emphasised if the tax applies only to nicotine-containing products and/or in proportion to the nicotine concentration. Additionally, the obligations for operators to comply with a harmonised regime would translate in an increase of regulatory burden that, although moderate in absolute terms, would add to the compliance costs recently borne to comply with Directive 2014/40. Since the market for e-cigarettes is primarily made of small businesses, the compounded effects of the regulatory burden and their limited tax bearing capacity may result in a loss of SME competitiveness. The impacts for tax administrations would also be mixed and differentiated between countries that currently have an *ad hoc* tax in place - which could benefit from EU-wide harmonisation in the form of a possible reduction of uncontrolled cross-border shopping - and countries that do not have it, which would face the costs of setting up the new tax and implementing it. Against this framework, and being aware that any measure in this area is not exempt from risks and downsides, **it is recommendable to adopt a harmonised tax category** for all kinds of consumables that are intended to be used in an e-cigarette device and consider, in a second stage, the application of a moderate EU minimum rate per volume of products, which could be reconsidered later when sufficient consensus is reached on the public health profile of these products.

### 4.3 Revision of excise duty structures

The policy problem connected to the relatively low degree of harmonisation of excise duty structures across the EU can be considered of secondary importance, as there is no evidence of major direct effects on competition or other notable adverse effects. The current situation would also not change significantly in the future, even in the absence of an EU intervention, since twenty countries reported no intention to modify their structures in the coming years. Additionally, in the current conditions both a removal of the mixed structure requirement or a closer harmonisation effort would directly touch only a limited number of countries so the impact of any policy change in this area would in any case be limited. Still, in a more indirect way, a **further step towards a closer harmonisation of excise structures** – i.e. reducing the upper threshold and augmenting the lower one – would be coherent with the general objective of ensuring a proper functioning of the internal market, so it can be recommended as a low-priority and light-touch measure.

As regards the 'minimum excise duty' (MED) there are two recommended revisions that could improve its effectiveness and provide a remedy to its possible unintended impacts. First of all, there is a widespread demand to clarify how, in practice, **the compliance of MED with the 'mixed structure' provisions** should be ensured, so as to remove all causes of legal uncertainties and disparities of interpretation between Member States. Secondly, it should be considered to provide a legal basis to **'dynamic' MED mechanisms** (such as the 'minimum total tax' inclusive of VAT), as additional options available to tax authorities to address more effectively the issue of market 'entry price' while reducing the risk of distortive impacts on competition.

### 4.4 Other complementary measures

In addition to the above main recommendations there are a few other measures of secondary relevance that can nonetheless be useful to consider in the event of a revision of the Directive. In summary:

- Since 'convergence' of tax levels between Member States would paradoxically require high-taxing countries to significantly slow-down their tax increases until low-taxing Member States catch-up, it is appropriate to reformulate this objective as 'bottom-up harmonisation' or similar notion.
- The actual measurement of the 'tax gap' between cigarettes and FCT is hampered by the lack of a clear equivalence between the two products. A non-binding conversion rate for fiscal purposes could be discussed and agreed between Member States at the technical level (e.g. under the *Fiscalis* programme).
- The excise definition of cigarillos should be harmonised with their customs definition to remove the existing inconsistencies in the classification of certain products (subject to the CJEU pending ruling on a related case).
- Based on the outcome of the ongoing discussions between Member States, there could be the need to refine the definition of 'smoking tobacco' to remove the risk of disparities of interpretation and classification, which would have negative repercussions on the cross-border movements of raw and semi-finished tobacco.
- The monitoring and analysis of water-pipe tobacco market needs significant improvement, with a view to ultimately adopt tailored measures (both fiscal and others) to reduce the high incidence of illicit trade.
- There is room to improve monitoring data and statistics reported by Member States to the Commission, ensuring that agreed data are timely provided and considering the addition of other possible useful data.

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### Finding information about the EU

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#### EU publications

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#### EU law and related documents

For access to legal information from the EU, including all EU law since 1952 in all the official language versions, go to EUR-Lex at: <http://eur-lex.europa.eu>

#### Open data from the EU

The EU Open Data Portal (<http://data.europa.eu/euodp/en>) provides access to datasets from the EU. Data can be downloaded and reused for free, for both commercial and non-commercial purposes.



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