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COMMISSION STAFF WORKING DOCUMENT

EVALUATION

of the

Council Directive

**2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to
manufactured tobacco**

{SWD(2020) 33 final}

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Glossary

| Term or acronym | Meaning or definition |
|---|--|
| Ad valorem | Duties levied on the maximum retail price of products and expressed as a percentage of it. |
| CJEU | Court of Justice of the European Union |
| CN | Combined Nomenclature |
| DG TAXUD | Directorate-General for Taxation and the Customs Union |
| E-cigarettes | A product that can be used for consumption of nicotine-containing vapour via a mouth piece, or any component of that product, including a cartridge, a tank and the device without cartridge or tank. Electronic cigarettes can be disposable or refillable by means of a refill container and a tank, or rechargeable with single-use cartridges. (see art 20 of Directive 2014/40) |
| EMCS | Excise Movement Control System |
| FCT | Fine-cut tobacco |
| FCTC | WHO Framework Convention on Tobacco Control |
| HTP | Heated Tobacco Products |
| Horizontal Directive | Council Directive 2008/118/EC |
| JRC | Joint Research Centre |
| MED | Minimum Excise Duty Minimum amount of excise duty (per quantity of product) that Member States can levy on certain tobacco products when the sum of specific and ad-valorem duties falls below an established threshold. |
| OLAF | The European Anti-Fraud Office |
| OST | Other smoking tobacco |
| Price elasticity of the demand | It is a measure of the change in the quantity demanded or purchased of a product in relation to its price change. A price elasticity of e.g. -0.5 means that if price changes by 10% the quantity demanded reduces by 5%. |
| Protocol | WHO Protocol to eliminate Illicit Trade in Tobacco products |
| RfC - Releases for consumption | The condition where excise goods are not under duty suspension arrangements and are therefore subject to the charging of the excise duty. |
| Specific Excise duty | Duties levied on the quantity of product and expressed as monetary sum per unit (i.e. per 1000 units, per Kg). |
| The study <i>or EA 2019</i> | “Study on Council Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco, Economisti Associati, 2019” |
| The tobacco tax Directive <i>or the</i> | Council Directive 2011/64/EU |

| | |
|-----------------------------|--|
| Directive | |
| TFEU | Treaty on the Functioning of the EU |
| TPD | Tobacco Product Directive |
| Total Tax Burden | The sum of the ad valorem and specific excise duty plus the value-added tax. |
| Track & trace | EU traceability system applying to tobacco products as put in place by the Tobacco Product Directive |
| WAP -Weighted Average Price | The weighted average retail selling price is calculated as the ratio between the monetary value of all products released for consumption, based on the retail selling price, divided by the total quantity released for consumption. |
| WHO | World Health Organization |
| WHO FCTC | WHO Framework Convention for Tobacco Control |

1. Introduction

Excise duties are indirect taxes on the sale and use of specific products. Union legislation lays down harmonised rules for excise duties on alcohol, tobacco and energy, as well as common provisions. Such legislation is aimed at ensuring that excise duties are coherently applied throughout the Union.

Council Directive [2011/64/EU](#)¹ (hereafter ‘the tobacco tax Directive’ or ‘the Directive’), lays down the EU rules for the taxation of manufactured tobacco products. The tobacco tax Directive aims at ensuring the proper functioning of the internal market and, at the same time, a high level of health protection.

The Directive is part of a broader EU policy framework that includes the common provisions applicable to all products subject to excise duties set out in Council Directive [2008/118/EC](#)² (also known as ‘the Horizontal Directive’), the customs union legislation, as well as key policies such as tobacco control policies³ and the policies against illicit trade and tax fraud⁴.

Furthermore, the EU is party to the WHO Framework Convention on Tobacco Control (FCTC)⁵ which in particular addresses tax and price measures to reduce the demand for tobacco products⁶. The EU is also party to the Protocol against Illicit Trade⁷.

The Directive identifies the tobacco products subject to the harmonised rules for excise duties and sets minimum levels of taxation (specified in Annex 4). In this context, the Member States are free to apply excise duty rates above these minimum levels of taxation according to their own national needs. All revenue from excise duties goes entirely to the Member States.

The Horizontal Directive should ensure that manufactured tobacco products are correctly taxed in the Member State of release for consumption (an exception to this general principle is foreseen in the event of acquisition by a private individual for his own use⁸). This is important, given that receipts from excise duties on manufactured tobacco

¹ [Council Directive 2011/ 64/EU](#) of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco (OJ L 176, 5.7.2011, p. 24–36). The Directive entered into force as of 1 January 2011

² [Council Directive 2008/118/EC](#) of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC (OJ L 9, 14.1.2009, p. 12).

³ Directive 2014/40/EU of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC

⁴ 2nd Action Plan to fight the illicit tobacco trade 2018-2022 - COM/2018/846 final

⁵ <https://www.who.int/fctc>

⁶ https://www.who.int/tobacco/control/measures_art_6/en/

⁷ The [Protocol](#) entered into force on 25 September 2018

⁸ Article 32 of Council Directive 2008/118/EC

contributed overall more than EUR 82.3 billion to the national budgets of Member States in 2017.

The Directive provisions are essentially of four kinds:

1. Provisions aimed at defining the different manufactured tobacco products that are subject to a harmonised treatment: cigarettes; cigars and cigarillos; and smoking tobacco (consisting of fine-cut tobacco for the rolling of cigarettes and ‘other smoking tobacco’, which includes e.g. pipe tobacco and water-pipe tobacco).
2. Provisions on the tax structures applicable to the various products defined, i.e. the ad valorem component, the specific component (per quantity or per weight), and the rules and limits for the application of a mixed structure, where required. It also lays down the rules for applying an optional minimum excise duty (MED) on certain products.
3. Provisions on the rates applicable to the different product categories, setting the minimum amounts of the excise duty applicable. It includes also the mechanism to calculate the weighted average retail selling price (WAP) for cigarettes and fine-cut tobacco.
4. Exemptions and derogations for certain countries or territories.

Finally, new tobacco products such as heated tobacco and electronic cigarettes (e-cigarettes) are not explicitly covered by the Directive currently. Although no separate category is provided for them, some of these products could be covered by the Directive to the extent that they meet the requirements of one of the manufactured tobacco products as currently defined.

1.1. Purpose

The evaluation⁹ looks at the implementation of the different provisions of the Directive, and assesses its application by the Member States. In particular, this evaluation analyses the effect of the minimum rates and structures of excise duty applied on manufactured tobacco. The evaluation assesses to which extent these provisions have contributed to:

- ensuring the proper functioning of the internal market;
- providing a high level of health protection and
- fighting against tax fraud, tax evasion and illegal cross border shopping.

This evaluation also covers the outstanding issues identified in the 2018 Commission Report¹⁰. That report presented the results and conclusions of an external study on this subject and set out the reasons why the Commission decided to not submit a proposal for

⁹ See Evaluation Tobacco Excise Directive Roadmap, published on 06/02/2018

¹⁰ See Commission report COM (2018)17 final

revision of Directive 2011/64/EU at that moment in time. One of the aspects examined by the report and the study was the tax treatment of novel products such as electronic cigarettes at EU level. As these markets were only emerging and rapidly evolving, sufficient data were not available to support a final position at the time when the report was issued. The purpose of this evaluation is to fill the information gaps in order to assess the correct harmonised approach for the taxation of those products.

This evaluation assesses the performance of the Directive against the basic evaluation criteria of effectiveness, efficiency, relevance, coherence and EU added value, in line with the Better Regulation Guidelines¹¹.

Therefore, the purpose of this evaluation is twofold. Firstly, it will assess whether the Directive has met its dual objective, which is to ensure the proper functioning of the internal market and, at the same time, ensure a high level of health protection, and further assess its contribution to other EU policies such as tobacco control and the fight against illicit trade. Secondly, this evaluation will assess whether new concerns and challenges have arisen since its adoption.

This evaluation will help to determine whether any subsequent policy action is needed in order to address the identified shortcomings and recent market developments.

1.1. Scope

The evaluation takes into account the Directive's objectives, all provisions of the Directive and the relevant case law from the Court of Justice of the European Union. The time period covered is from the adoption of the Directive until the availability of the latest reported data (2011 to 2017).

The evaluation focuses on obtaining an overview of the EU and the geographical coverage is all 28 Member States.

This report is based in particular on a comprehensive external study for an ex-post evaluation of the tobacco tax Directive (hereafter 'the study') with the majority of the tasks carried out in 2018 and which concluded in January 2019¹². This study notably builds on a public stakeholders' consultation carried out between 23 May 2018 and 3 September 2018 as well as numerous stakeholders' consultation activities and extensive desk research.

¹¹ Better Regulation Guidelines

¹² Study on Council Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco, Economisti Associati, 2019

2. Background to the intervention

2.1. Description of the intervention and its objectives

Council Directive 2011/64/EU codifies the previous common fiscal legislation on manufactured tobacco in the EU in a single act, and most notably the revisions by Council Directive 2010/12/EU¹³. The 2010 Directive was adopted in order to achieve a dual overarching goal¹⁴: to ensure the functioning of the internal market and a high level of human health protection. This dual role putting the two objectives at the same level is therefore central to the Directive.

The specific objectives are more directly connected with the mechanisms and tools of the tobacco excise legislation taken over from the previous tobacco tax Directive and codified into the Directive. These specific objectives are to:

- (i) Support EU market integration (i.e. avoid partitioning of geographical market) and removal of obstacles and barriers to it (recital 3).
- (ii) Avoid tax-induced competition distortions, both cross-country (between low- and high-taxing countries) and cross-product (between products subject to different levels of taxation) (recital 9).
- (iii) Ensure freely-formed prices for all groups of manufactured tobacco in all geographical markets (recital 10).
- (iv) Pre-empt fraud and smuggling (tax avoidance, circumvention and ‘abuse’ of tax categories) (recital 15).
- (v) Deter consumption through taxation and reduce access to ‘less-taxed’ alternatives (recital 16).
- (vi) Ensure a proper functioning of the excise duty system.¹⁵

The reconstructed intervention logic underpinning the evaluation is presented below. It is mainly based on the recitals of the Directive and the analysis of the accompanying documentation at the time of the preparation and negotiations of the Directive (especially the 2008 impact assessment report¹⁶).

The starting point are the problems that were identified in 2008 during the preparation of the Directive (see figure 1, the orange frame). The activities/actions presented in the intervention logic are essentially the Directive provisions, which are of three main types: (i) the adoption of common product definitions, tax categories and procedures; (ii) the

¹³ In particular, Directives 92/79/EEC, 92/80/EEC, 95/59/EC on the structure and rates of excise duty applied on manufactured tobacco and subsequent amendments of Council Directive 2010/12/EU.

¹⁴ Recital 2: “in order to ensure the proper functioning of the internal market, and, at the same time, a high level of public protection”

¹⁵ The text of Directive 2011/64/EU does not mention among its objectives the proper functioning of the excise system, which is the subject of Directive 2008/118/EC (the ‘Horizontal’ Directive), but it seems implicit that the rules and provisions of Directive 2011/64/EU should also ensure effective and efficient administration of excise duty on tobacco and collection of tax receipts.

¹⁶ See impact assessment report [SEC\(2008\)2266](#).

harmonisation of the excise duty structures for the different categories of products and (iii) the establishment of minimum excise duty rates.

The objectives of the Directive can be broken down into specific ones, which are close at hand and could be reached in the medium term and the general ones, which are meant to be reached in the long term.

Once the objectives had been set out, it was believed that by carrying out the activities mentioned in the Directive certain results would materialise. In the medium term, there would be:

1. harmonisation in the excise duty structures applied by the different Member States;
2. progressive convergence in the tax rates applied by the Member States to different categories of potentially substitute products, and in particular cigarettes and fine-cut tobacco;
3. the establishment of a tax 'floor' to reduce the affordability of tobacco products for consumers by keeping the 'entry price' sufficiently high;
4. sufficient flexibility in the application of rules to local conditions and - where needed - derogations, to facilitate adaptation and to prevent market disruptions and unintended side effects;
5. an overall coherent interpretation and application of EU definitions, categories and rules by all Member States authorities (i.e. removing any legal uncertainties that might possibly lead to discrepancies of classification or implementation).

In the long term and corresponding to the general objectives, certain impacts were expected to take place:

1. the market was expected to be functioning without distortions;
2. the level of tax receipts would not be negatively affected;
3. regulatory costs would be minimal in comparison with the savings that would stem from a harmonized system for tobacco products;
4. illicit trade affecting tobacco products would be reduced;
5. smoking prevalence level would diminish, with fewer people smoking in the EU.

Several external influencing factors have also been identified. These factors, although independent and outside the scope of the Directive are of importance because they can undermine or make stronger the effects of the intervention.

The evaluation sought to test the links between the different elements mentioned in the intervention logic and verify if the expected results and impacts have materialized.

Figure 1. Intervention logic



Source: European Commission

2.2. Baseline and points of comparison

EU-level harmonised rules on the excise duty applicable to manufactured tobacco have been in place since the 1970s¹⁷. Many definitions are still in place since this period. For the evaluation of the Directive it is important to consider the origin of the rules and provisions of the Directive and to distinguish ‘legacy’ measures from more recent ones. As Directive [2011/64/EU](#) essentially codified the previous Directive [2010/12/EU](#), the relevant differences are actually between this and pre-2010 versions.

At the same time, it is important to establish whether the current legal framework on the whole is still fit for purpose, i.e. whether needs and priorities are met, whether the fiscal policy is still aligned with other related policy frameworks and goals (e.g. public health policies, anti-fraud policies) and whether there are emerging issues not (sufficiently) addressed in the legal text currently in force. This dimension goes beyond the specific revisions introduced in 2010 and questions the overall fitness of the current EU framework especially in an interim and forward-looking perspective. This dimension includes, for instance, the issue of recent products such as heated tobacco products and electronic cigarettes as well as the emergence of other new products.

3. Implementation / state of Play

3.1. Description of the current situation

The Directive defines the fiscal structures and the minimum levels of taxation to be applied to manufactured tobacco products.

Transition periods and several temporary derogations, allowing reductions and exemptions, had been granted to Member States in the Directive. The main transition period allowing some Member States until 31 December 2017 to reach the minimum requirements for overall excise duty (specific duty and ad valorem duty excluding VAT) has now expired¹⁸. Only one transition period foreseen in the Directive has yet to come into effect with the last stage of the gradual increase of minimum rate foreseen for fine-cut tobacco as of 1st January 2020¹⁹.

Several actual and potential problems over the years have been identified as regards the structure and the implementation of the Directive and were reported in the previous evaluations and reports²⁰.

¹⁷ Council Directive [72/464/EEC](#) and Council Directive [79/32/EEC](#)

¹⁸ Article 10(2) provides for a transitional period until 31 December 2017 for certain Member States (Bulgaria, Estonia, Greece, Latvia, Lithuania, Hungary, Poland and Romania) to reach the 60% overall excise duty level. In accordance with Croatia’s Accession Treaty, Croatia was allowed the same transitional period.

¹⁹ From 1 January 2020, the overall excise duty on fine-cut tobacco intended for the rolling of cigarettes shall represent at least 50% of the weighted average price, or at least EUR 60 per kg -Article 14(2)

²⁰ See Commission Report [COM\(2015\)621 final](#) and Commission Report [COM\(2018\)17 final](#)

The main problems identified were:

- Subjective criteria²¹ in the definitions of some product categories resulting in legal uncertainty;
- Tax-induced substitution between products, notably between cigarettes and fine-cut tobacco, and to some extent 'borderline' cigarillos (cigarillos which have some characteristics similar to cigarettes such as dimension, filter, packaging, etc. but can be sold to a much lower price thanks to a more favourable tax treatment). ;
- Different applications of the Minimum excise duty rules by Member States;
- The lack of a proper control system for raw tobacco and the risks of diversion to the illegal circuit;
- Dual classification for excise and customs for the same products;
- Demand for illegal products;
- Disparities in the tax treatment of novel products across Member States.

In general, it was verified that the Directive is still in line with the evolution of other EU policies, initiatives and measures as presented in the following section on the state of play. The evaluation verified whether certain provisions of the Directive should be reviewed because they are outdated, due to developments of other EU policy instruments and /or in light of the various CJEU rulings²².

The previous evaluation study and reports confirmed in particular the lack of legal certainty of a number of provisions in the Directive²³. In an opinion delivered in 2016, Advocate General Wahl noted that *“Four decades after the introduction of the first directive on the harmonisation of excise duties on manufactured tobacco products it may come as some surprise that the provisions laid down by the most recent directive on the matter still require interpretation by the Court of Justice”*²⁴.

A new evaluation was needed following the conclusions of the 2018 Commission Report. This report set out the reasons why the Commission decided to not submit a proposal for revision of Directive 2011/64/EU at that moment in time. One of the main reasons was notably the lack of data on novel products such as electronic cigarettes at EU level. Another reason was that minimum rates could not be examined because some of the current transitional periods had not yet ended and not all increases had entered into force.

3. 2 State of play

Including value added tax (VAT) the total tax revenue from tobacco products in the EU amounted to EUR 106.5 billion in 2016, with the VAT component accounting for about ca. 22.5% of the total. Overall, this figure represents some 2.7% of the total tax revenue (including VAT) collected in the EU.

²¹ For example: ‘capable of being smoked’, ‘without further industrial processing’, ‘consumer expectations’, ‘exclusively intended to be smoked as it is’

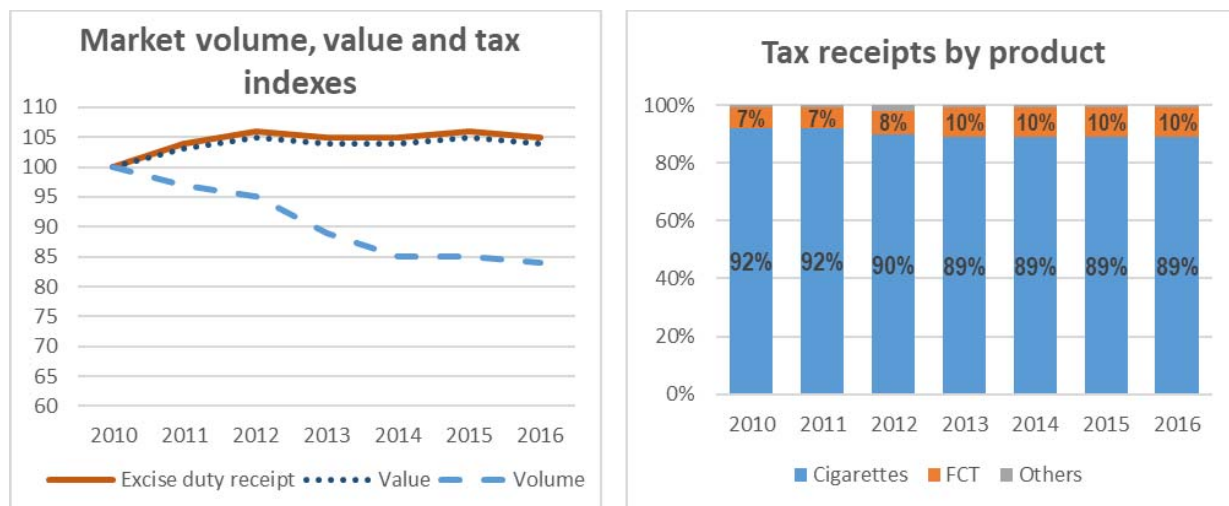
²² See a list of the main CJEU rulings in annex 5

²³ Ramboll, EA 2017

²⁴ AG Wahl, case C- 221/15, Etablissements Fr. Colruyt.

Cigarettes remain by far the main source of these tax receipts. Despite reduced consumption levels, excise duty receipts have slightly increased. Overall, the total excise duty revenue from tobacco in 2016 was EUR 82.3 billion (59% of market value, increasing by 0.7% (year-on-year) for the 2010-17 period.

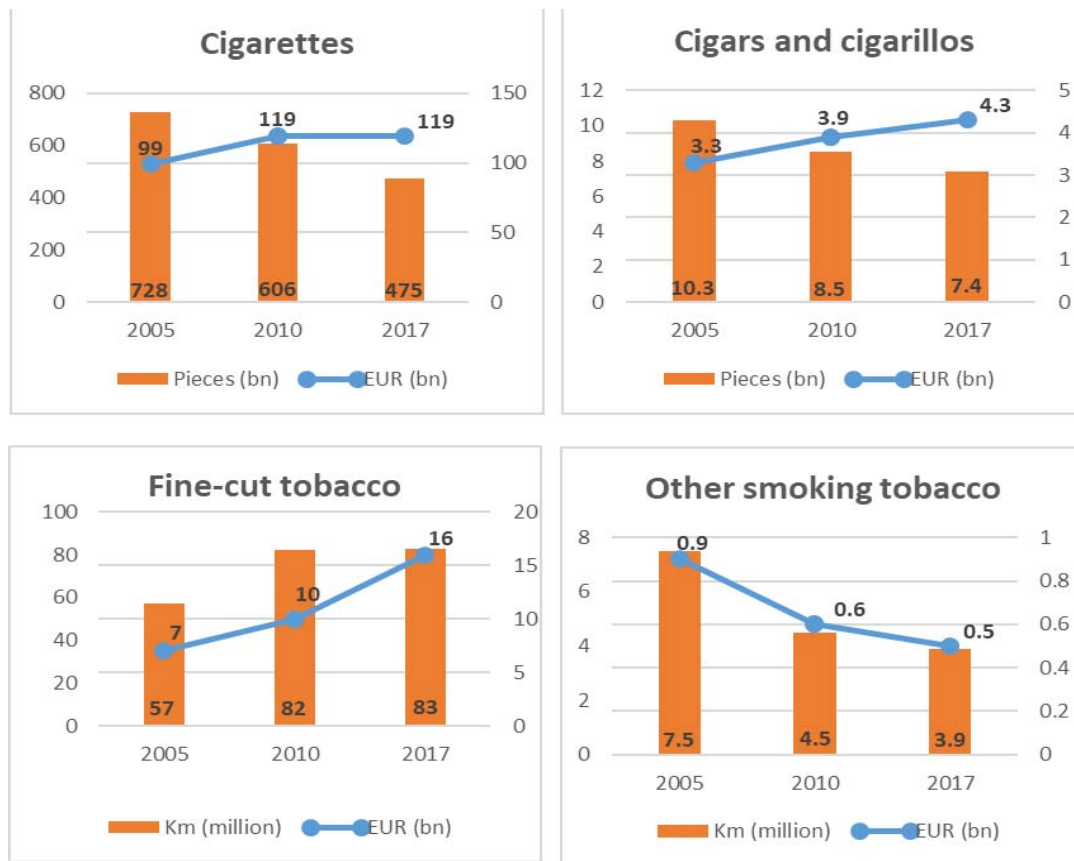
Figure 2. Tobacco market statistics



Source: EA study 2019

During the period covered by this evaluation, the global sales of tobacco products continue the decreasing trend already experienced during the previous period. A notable exception is fine-cut tobacco where the volumes are slightly growing while there is a strong raise in market value linked to the price increase. The figure below presents the overall EU market trends since 2005.

Figure 3. Trends for tobacco products



Source: EA study 2019

E-cigarettes are currently not subject to a harmonised tax under the Directive. The main commercial uptake of e-cigarettes in the EU started after the adoption of Directive 2011/64/EU, which is therefore silent on their taxation. However, almost half of Member States have since then introduced an ad hoc tax at national level. The Tobacco Products Directive adopted in 2014 lays down rules governing the manufacture, presentation and sale of tobacco and related products. In particular, it provides for a definition of e-cigarettes²⁵. In line with its Article 20, e-cigarette is a product that can be used for consumption of nicotine-containing vapour via a mouth piece, or any component of that product, including a cartridge, a tank and the device without cartridge or tank. Electronic cigarettes can be disposable or refillable by means of a refill container and a tank, or rechargeable with single-use cartridges.

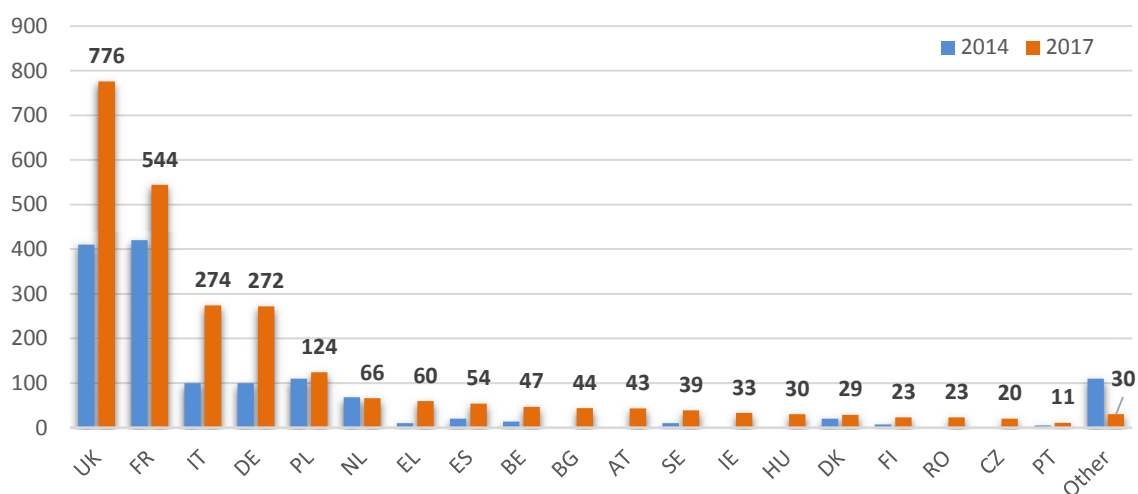
Official data on the size of the e-cigarettes market and consumption levels are still unavailable. However, the study was able to present solid estimates based on various sources.

²⁵ see art 20 of [Directive 2014/40/EU \(OJ L 127, 29.4.2014, p. 1–38\)](#)

The number of e-cigarettes regular consumers in the EU has doubled between 2013 and 2017 from approximately 6 to more than 12 million users. The majority of them use e-cigarettes daily. Converting non-daily into daily-equivalent users, the total number of users is estimated to be close to 10 million. The highest prevalence is registered in the United Kingdom and France where it exceeds 4-5% of the population, while in other EU countries it typically amounts to 1-2%.

The value of the e-cigarettes market in the EU is estimated at about EUR 2.54 billion (2017). The estimates indicate that the largest national markets are, the United Kingdom (EUR 776 million) and France (EUR 544 million). Italy, Germany and Poland are also relatively large markets, worth between EUR 100 and 300 million.

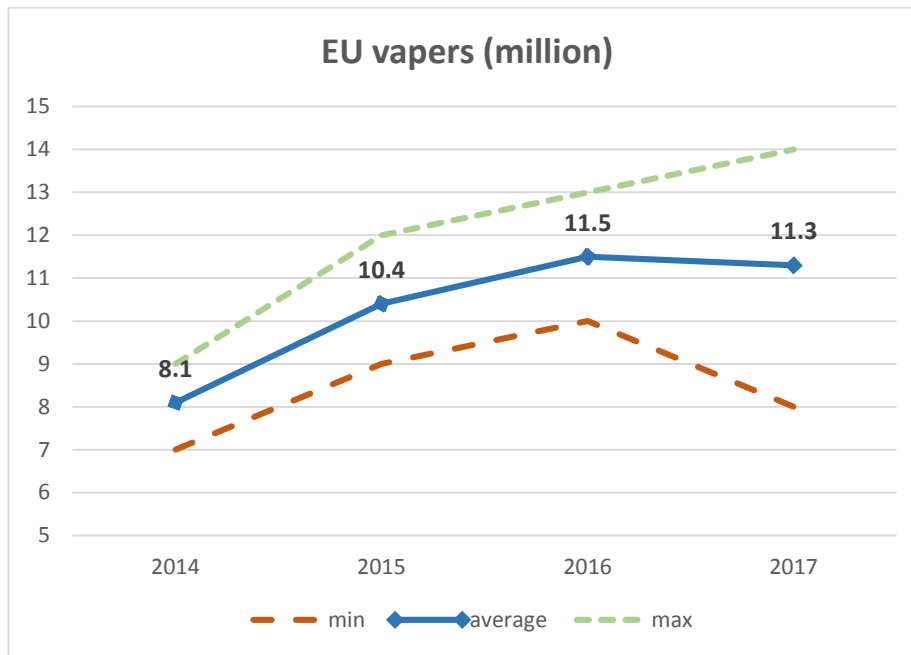
Figure 4. Estimated market value of e-cigarettes in Member States (EUR million)



Source: EA study 2019

Recent market trends remain unclear for e-cigarettes depending on the source of the market estimates as shown in Figure 5 below, with the market steadily growing in the most positive market outlook or a substantial slow-down in the worst case scenario. Demand for e-cigarettes started to grow rapidly in the early 2010s, but appears to be levelling off. The emergence of new products could also affect the future market developments.

Figure 5. E-cigarettes market trends in the EU



Source: EA study 2019

Heated Tobacco Products (HTP) are also not explicitly mentioned in Directive 2011/64/EU since the product appeared on the market after its entry into force. Member States have different views on whether it should be considered as an excisable manufactured tobacco product or not and, if taxable, which excise category can be applied. In less than two years, HTP have been introduced in 17 Member States and further expansion is expected, so more and more tax authorities have been called to decide which regime to apply. The level of fragmentation is high, with some Member States applying an ad hoc tax regime while others chose to include them under the 'other smoking tobacco' harmonised category.

Market size in 2017 was 1.9 billion pieces with a market value of EUR 432 million. With other competing products with similar concepts being launched and other new generation platforms being developed, it is expected that the market will continue evolving rapidly in the near future. The rapid uptake in Japan ²⁶of heated tobacco is an indication of the potential of these products although specific cultural drivers should be taken into account.

²⁶ <https://tobaccoatlas.org/>

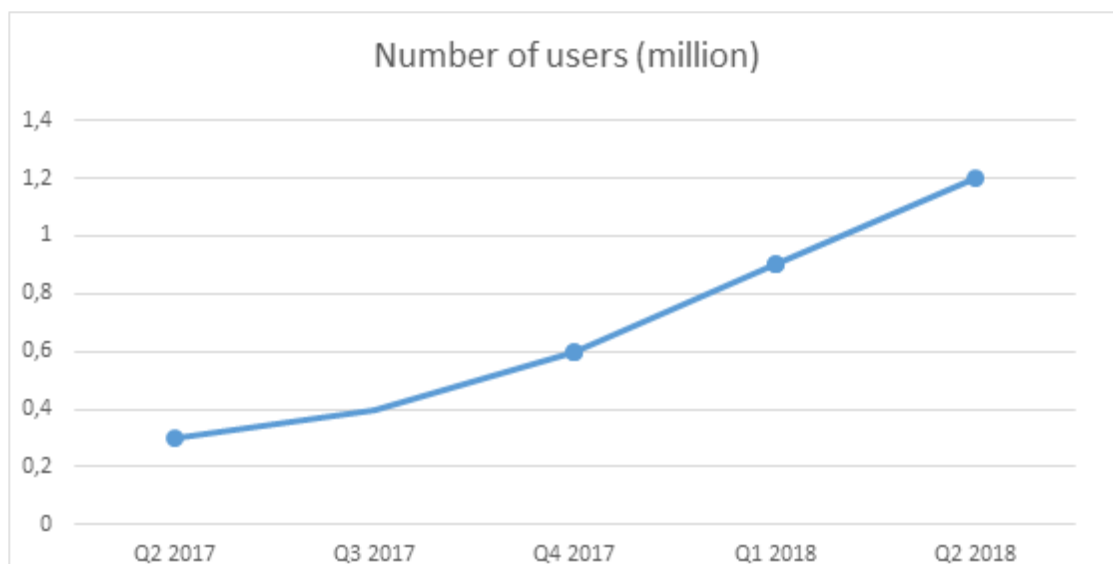


Figure 6. Users of heated tobacco products in the EU

Source: EA study 2019

It is important to stress that the market value for e-cigarettes and heated tobacco products remain however small (around EUR 3 billion) in comparison to the total cigarette market, valued at approximately EUR 119 billion.

Finally, market developments in products that can be seen as substitutable to cigarettes have been accelerating in the past months and years.

The consumption of smokeless tobacco products and notably commercial chew bags of nicotine (as opposed to medical gums) appears to be growing, mostly in Northern Europe. Sale of snus is illegal in all the EU except Sweden but it is legal for foreign travellers to buy (and carry back personally) for personal use. Despite this constraint and requirement, other neighbouring Member States are affected and for example 8% of boys aged 14-20 years are daily users of snus in Finland²⁷.

The potential growth of cannabis products has also been reported recently, notably as vaporisation of CBD (cannabidiol) which can be used in electronic vapour devices²⁸.

²⁷ [Finnish Institute of Health and Welfare, Tobacco Statistics, appendix tables 9 and 10](#)

²⁸ The Single Convention on Narcotic Drugs (1961) limits the use of cannabis or cannabis resin exclusively to medical and scientific purposes. cannabidiol, although not expressly listed in the schedules of the International Drug Control Conventions, is covered by the entry “Cannabis and cannabis resin and extracts and tinctures of cannabis” in Schedule I of the Single Convention on Narcotic Drugs provided that it is obtained as an extract of cannabis (and not artificially synthesised).

4. Method

4.1. Short description of methodology

The retrospective evaluation of the Directive can be broadly classified as a theory-based evaluation. It implies working on the basis of an intervention logic, which describes the Directive through a diagram of logically connected elements: the original problems which were meant to be addressed, the provisions of the Directive (activities), the objectives to be reached (both specific ones as well as general one), the expected results and broader impacts. An intervention logic was reconstructed for the purpose of the present evaluation (see figure 1) and constituted the point of departure for the analysis.

The study supporting the evaluation of the Directive followed a mixed-methods approach, featuring a range of tailored and targeted techniques and tools. The analysis was based predominantly on the desk research, analysis of economic and statistical data, numerous consultations with stakeholders and Member States administrations (both fiscal administrations and public health authorities) and a public consultation. All information about the scope, organisation and context of the supporting study as well as all the operational details behind the methodological choices are included in Annex 3.

4.2. Limitations and robustness of findings

The study findings largely rely on extensive panel data. The consultant was able to collect a wide range of data set and secure consistency between them to come up with a solid analysis.

The main challenge was the lack of validated and comprehensive data (notably due to inconsistencies, incompleteness of data, and lack of verifiable independent sources), in particular, for illicit trade, smoking prevalence and electronic cigarettes. However, the study made a determined effort at getting estimates and at the triangulation of the different available sources.

For example, for cross-border trade, no valid source of data is currently available to estimate the final use of cigarettes moved. The study worked out an estimate of the share of cigarettes actually intended for legitimate own consumption against those that are instead diverted to illicit reselling.

The consultant carried out an inventory of available data during the inception phase of the study. Some of the datasets identified turned out to be incomplete or inconsistent to support an econometric assessment. To address the numerous consistency and completeness issues that emerged the consultant engaged in a substantial effort of systematisation of datasets. This effort resulted in the provision of a thorough answer to the descriptive questions on the overtime trends in the market and taxation of tobacco, and the utilisation of these data in the quantitative analysis models further detailed in Annex 3.

This considerable effort by the consultant already signals the need for a more efficient monitoring and data reporting, and notably a better use of the Commission Implementing Decision of 2011²⁹ which indicates the list of statistical data on the structure and rates to be reported by the Member States.

5. Analysis and answers to the evaluation questions

5.1. Effectiveness

This section analyses the progress made towards achieving the objectives set by the Directive, and in particular the functioning of the internal market, the fight against tax fraud and illicit trade and ensuring a high level of health protection.

Evaluation question:

To what extent have the current minimum rates helped and supported in ensuring the proper functioning of the internal market (including competition)?

The importance of revenue collection from tobacco excise duties for the budget of Member States

An important aspect to be considered is the quantification of revenues for the Member States: the figures below show the importance of tobacco tax revenues for Member States. The levels of tobacco tax revenues are diversified in the EU and generally deliver a relevant contribution to the budget of the Member States as shown in Table 1.

²⁹ Commission Implementing Decision of 28 July 2011 concerning the list of statistical data on the structure and rates of excise duty applied on manufactured tobacco to be provided by the Member States pursuant to Council Directives 92/79/EEC and 92/80/EEC

Table 1. Tobacco tax incidence on Member States total tax revenue

| MS | Excise Duty Revenue 2016 (€ million) | Excise Duty+VAT Revenue 2016 (€ million) | Excise Duty+VAT / TTR ratio 2016 |
|-----------|---|---|-------------------------------------|
| AT | 1,835 | 2,356 | 2.4% |
| BE | 2,351 | 3,086 | 2.4% |
| BG | 1,178 | 1,477 | 14.5% |
| CY | 189 | 237 | 5.2% |
| CZ | 2,014 | 2,637 | 7.5% |
| DE | 14,182 | 18,187 | 2.4% |
| DK | 956 | 1,312 | 1.0% |
| EE | 192 | 248 | 5.1% |
| EL | 2,504 | 3,296 | 6.8% |
| ES | 7,211 | 9,285 | 3.7% |
| FI | 968 | 1,213 | 1.8% |
| FR | 11,043 | 14,065 | 2.2% |
| HR | 592 | 795 | .. |
| HU | 1,008 | 1,419 | 4.8% |
| IE | 1,098 | 1,405 | 2.6% |
| IT | 10,711 | 14,015 | 2.8% |
| LT | 274 | 361 | 5.3% |
| LU | 533 | 684 | 4.7% |
| LV | 190 | 244 | 4.3% |
| MT | 87 | 108 | 4.0% |
| NL | 2,491 | 3,278 | 1.9% |
| PL | 4,189 | 5,488 | 6.2% |
| PT | 1,513 | 2,010 | 4.3% |
| RO | 2,057 | 2,729 | 9.0% |
| SE | 944 | 1,280 | 0.7% |
| SI | 412 | 537 | 6.0% |
| SK | 672 | 914 | 6.2% |
| UK | 11,095 | 13,847 | 2.1% |
| EU | 82,488 | 106,512 | 4.4% |

TTR= total tax revenues

Source: EA study 2019

The contribution of the Directive to the convergence of tax levels between Member States has been mixed

The ‘convergence’ objective of the EU excise legislation is primarily aimed at preventing the risk that high tax differentials may generate significant flows of products from low-tax to high-tax countries with ensuing distortive effects on competition, on tax receipts of Member States. This would ensure the smooth functioning of the Single Market.

In order to attain that convergence, an EU minima was introduced. The EU minima were intended inter alia to facilitate convergence in the tax rates applied in Member States, that is a reduction in the ‘gap’ between the lowest and the highest-taxing countries.

Evidence from the study indicates that the Directive provisions on minimum excise rates have been moderately effective in raising tax rates and prices in Member States, especially in the case of cigarettes and fine-cut tobacco, and with particular reference to the low-price segment of the market.

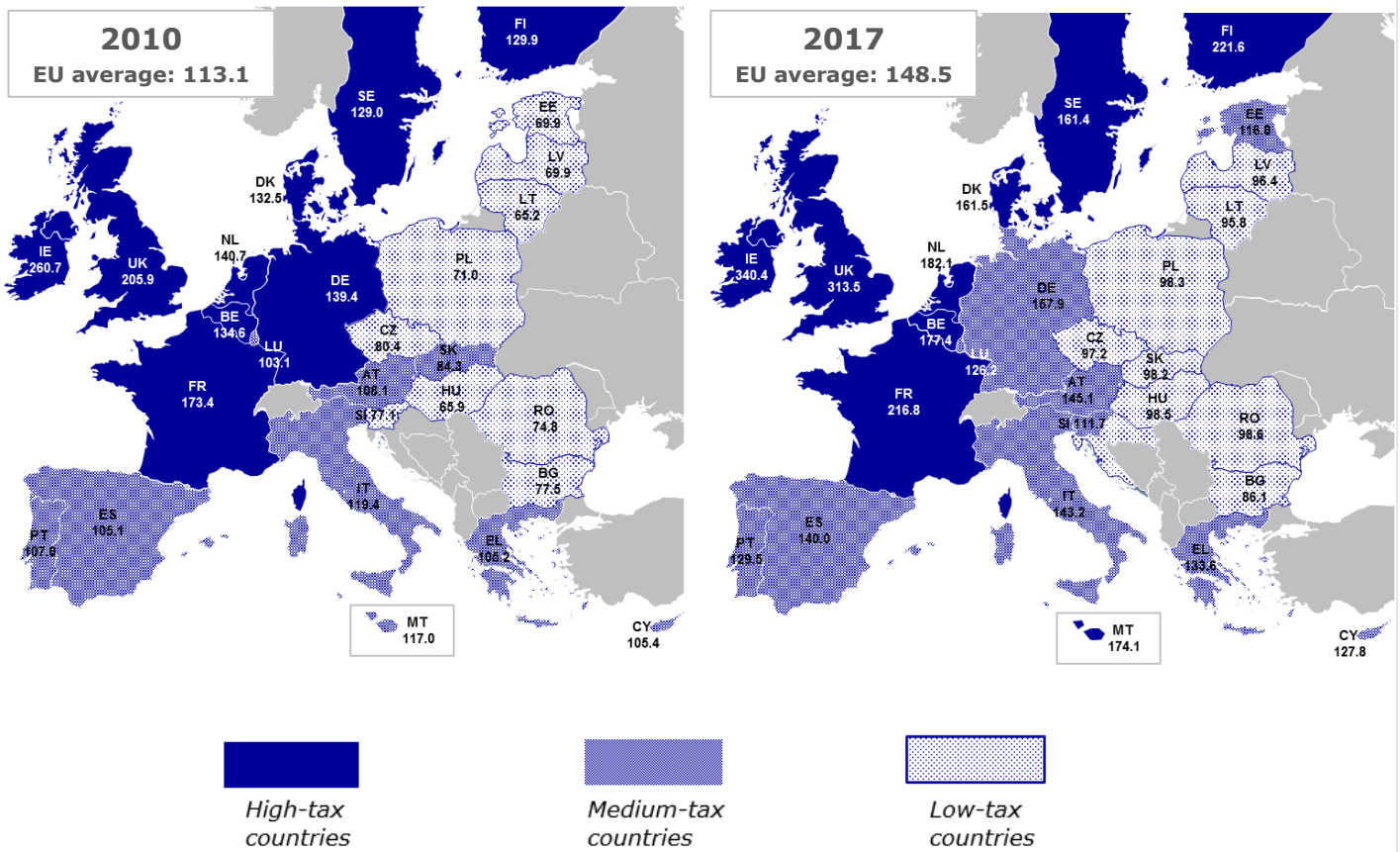
According to the study, the contribution of the Directive to the convergence of tax (hence price) levels between Member States has been mixed. In fact, the gap between ‘high-tax’ and ‘low-tax’ countries has slightly expanded as a result of some Member States having adopted a strong public health agenda and having further increased their rates. EU minimum rates have however contributed somewhat to mitigating such a larger gap with a progressive increase and a transitional period granted to a number of Member States until end 2017. Transitional periods were granted to allow some Member States³⁰ to adapt smoothly to reach 60% overall excise duty level, thus limiting possible side effects.

Overall, the achievement of the ‘convergence’ objective by means of EU minima provision appears inherently problematic. Convergence would require not only a ‘minimum floor’ but also a ‘maximum ceiling’ target. Maximum rates are unfeasible and undesirable from a public health perspective. In this sense, the EU minima do not seem fit to achieve a significant degree of convergence, although they may still help avoiding that tax (and price) differentials get even wider.

The figure below illustrates the degree of convergence occurred in Member States excise rates compared to what happened to prices. The excise duty yield represents specific duty and the ad valorem duty levied per quantity of products (units or weight), measured at the level of the weighted average price. As seen in figure 7, excise duty yields levels have grown in all Member States in the 2010-17 period, with the EU average moving from EUR 113.1 to EUR 148.5 per 1000 cigarettes, in current price terms.

³⁰ Article 10(2) of the Directive provides for a transitional period until 31 December 2017 for certain Member States (Bulgaria, Estonia, Greece, Latvia, Lithuania, Hungary, Poland and Romania) to reach the 60% overall excise duty level.

Figure 5. Excise yields of cigarettes in Member States (2011 and 2017) (Excise duty levied in EUR per 1000 sticks)



Source: EA study 2019

Effectiveness of the tax structure requirements

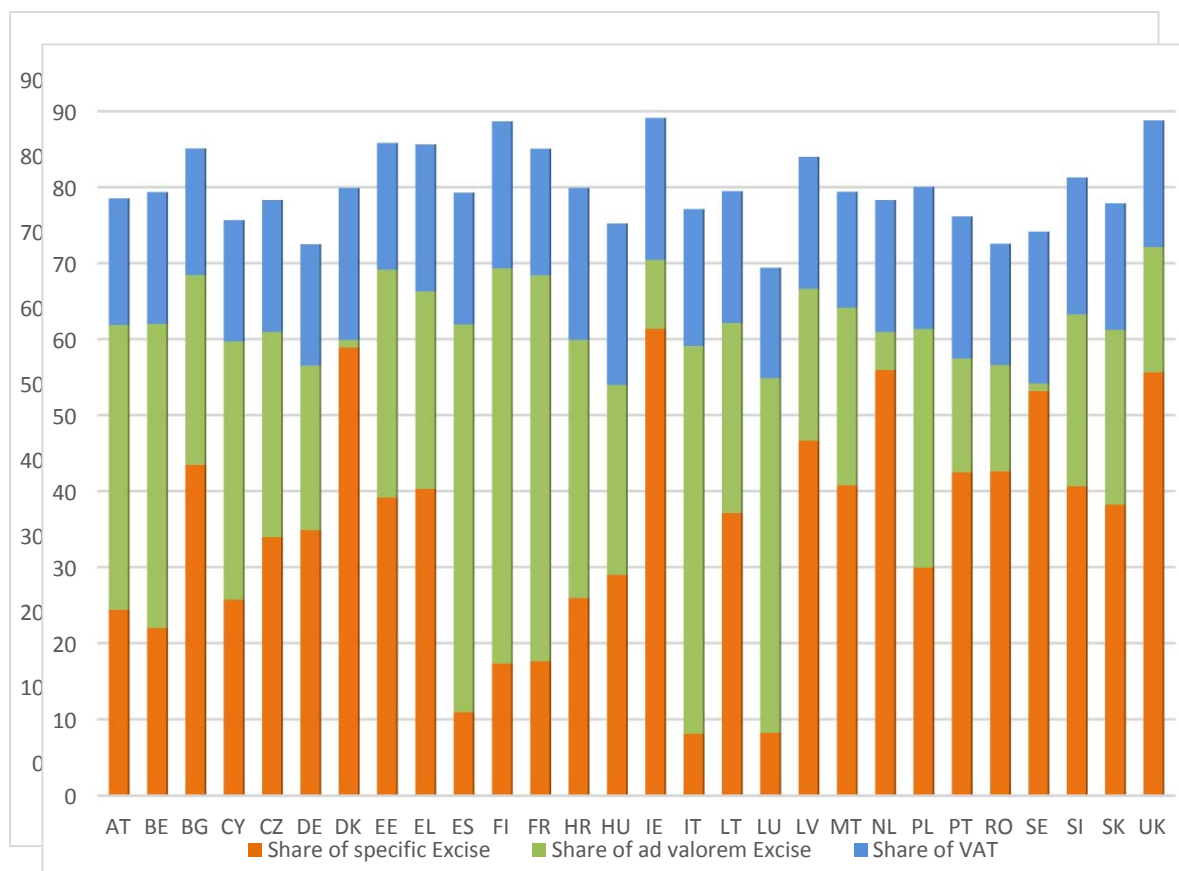
The Directive requires Member States to levy a minimum rate of excise duties on cigarettes, as a way to deter consumption through taxation and to ensure that at least a certain minimum amount of taxation applies throughout the Union. The minimum rate must consist of a specific component and ad valorem component. The mixed structure gives Member States sufficient leeway in setting the rates. The ad valorem element is a percentage of the retail price. The specific element is a set amount of money per 1,000 cigarettes. This mixed structure requirement leaves some flexibility to adapt the level of each component nationally.

As regards this tax structure, the study notes that Member States have slightly increased their reliance on specific taxation as opposed to ad valorem taxation in the period considered. However this process was only indirectly related to the very flexible provisions of the Directive in this area, and therefore the evidence of impacts of the Directive on tax revenue stability or price accessibility is not apparent.

The study indicates that overtime there is an increased incidence of the specific component of the excise duty in Member States. However the rather wide 7.5%-76.5% of

the total tax burden threshold for the specific component on cigarettes should be noted and the difference in excise duty structure remain significant (the specific component varies from 10% in Italy to 74% in Denmark).

Figure 8. Structures of taxation on cigarettes in percentage of the Weighted Average Price



Source: DG Taxud Excise Duty Tables, as of July 2018

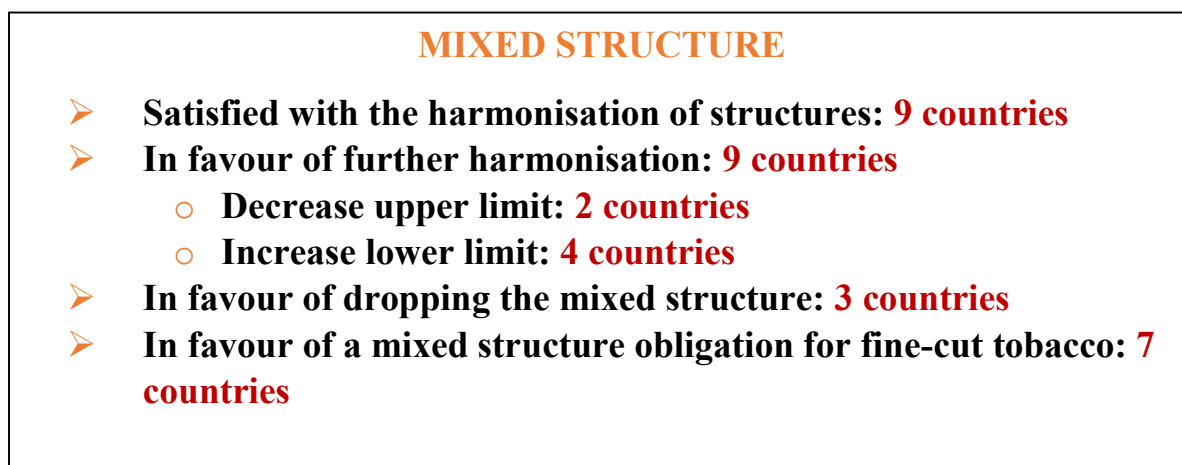
More concrete impacts are associated to the recourse to the ‘minimum excise duty’ (MED) provision, e.g. on price convergence and reduction of price accessibility.

The Minimum Excise Duty represents the minimum amount of excise duty (per quantity of product) that a Member State can decide to levy on certain tobacco products when the sum of specific and ad-valorem duties falls below an established threshold that is defined nationally. Recital 12 of the Directive notes that Member States should be given effective means to levy specific or minimum excise duty on cigarettes, so as to ensure that at least a certain minimum amount of taxation applies throughout the Union. The MED consists in a tax ‘floor’ and was designed to prevent the risk of too low taxation (hence too low prices) and ‘race to bottom’ in the cheaper segments of the market.

The study shows 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.

The current structure of the tax is not perceived as posing major problems for Member States.

Figure 9. Feedback from Member States on the harmonisation of structures



Source: EA study 2019, based on the targeted consultation of national authorities

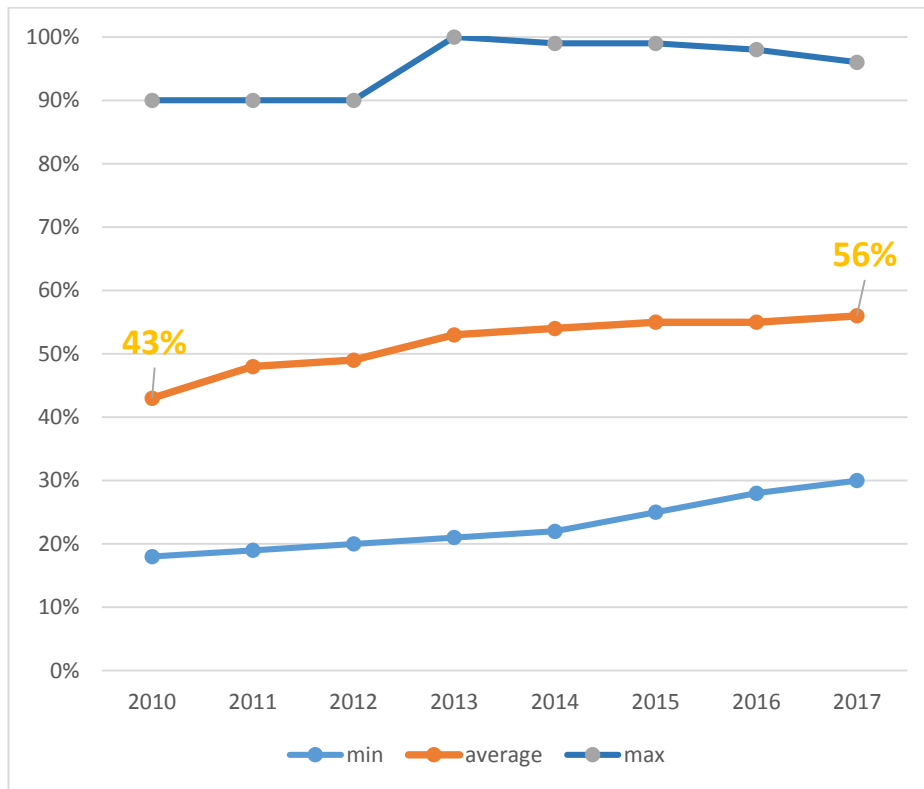
Fine-cut tobacco tax gap still an issue

One of the underlying principles of the Directive was to ensure similar effects on cigarettes and on fine-cut tobacco (FCT). However, the difference in the monetary EU minimum rates for the two products has not reduced in the 2011-2017 period. The price differential remains high in Belgium, Luxembourg and Germany where the FCT/cigarettes price ratio is lower than 40%. By contrast, in Bulgaria, Greece and Sweden the ratio exceeds 90%. In other words, it is relatively much cheaper to buy fine-cut tobacco instead of cigarettes in Belgium than it is in Greece.

Many Member States have autonomously increased the taxation of fine-cut tobacco more than cigarettes and as a result tax-induced substitution has slowed down, but the contribution of the Directive to this aim remains insufficient.

Figure 10 shows that the tax level ‘gap’ between cigarettes and fine-cut tobacco remains. The Directive was not entirely effective in reducing this gap.

Figure 10. Fine-cut tobacco/cigarettes price ratio across the EU (at WAP)



Source: EA study 2019

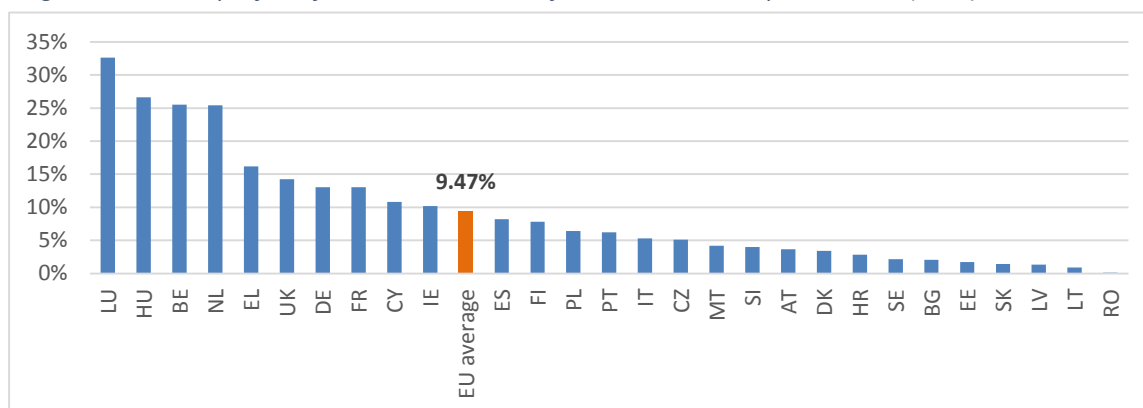
Furthermore, a clear and agreed equivalence in terms of conversion rate between cigarettes and fine-cut tobacco is missing in the tobacco tax directive³¹. As the study notes, there is no standard equivalence between FCT (expressed in grams) and cigarettes (expressed in sticks), so the comparison of rates is not straightforward.

It should be noted that there is still one outstanding increase of the minimum rate for FCT provided for in the Directive to take place in 2020. Despite this final increase, the gap remains a source of concern (see also the section on relevance in section 5.4).

As shown in Figure 11, fine-cut tobacco represents a significant source of revenue for some Member States.

³¹ A '0.75g per stick' equivalence is used in the Tobacco Product Directive

Figure 6. Tax receipts from fine-cut tobacco out of total tobacco receipts in the EU (2017)



Source: EA study 2019

Evaluation question:

To what extent have the current minimum rates helped and supported in fighting against tax fraud, tax evasion and illegal cross-border shopping?

Illicit trade and unrecorded tobacco consumption

Tobacco taxes and tax systems may create financial incentives for those who engage in legal and illegal activities to either reduce (tax avoidance) or completely avoid tax liabilities (tax evasion). The general rule is that taxes on tobacco products have to be paid in the Member State of release for consumption according to the rate in place there.

As noted in the impact assessment³² for the revision of the Horizontal Directive³³, the movement of excise goods has a high inherent fiscal risk. For tobacco products notably, the following reasons appear particularly relevant:

1. The duty rates of tobacco products lead to a taxation burden that is much greater than the net value of the goods.
2. The duty rates vary greatly from one Member State to another, which acts as a strong incentive to fraudsters to divert excise goods from low-rate Member States to re-sell them to the illicit markets of high-rate Member States.
3. The total amount of excise duty due on excise goods is collected from one tax payer at a single time and location, which makes excise duty more vulnerable to fraud than other types of indirect taxes³⁴.

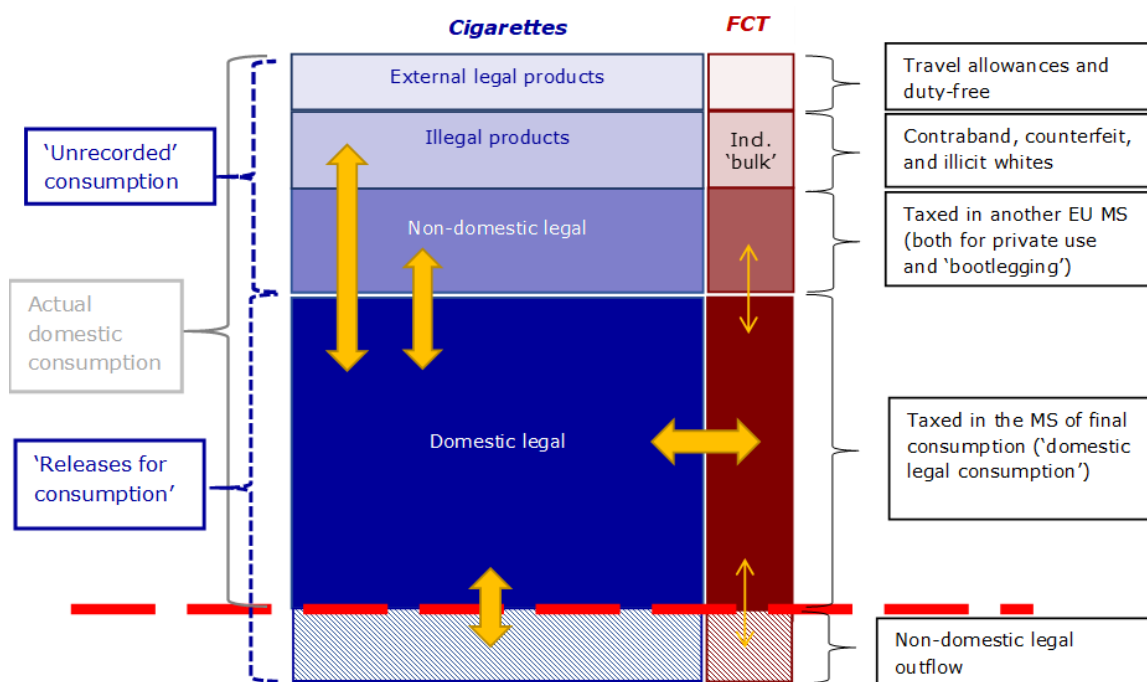
³² See Impact Assessment report [SWD\(2018\)259 final/2](#)

³³ OJ L 316, 31.10.1992, p. 21.

³⁴ For instance, VAT is collected at each step of the supply chain and requires information reports for both sales and purchases. Moreover, one firm's revenues are another firm's costs and consequently VAT evasion incentives are mutually inconsistent.

The schema below helps visualising the existence of an unrecorded tobacco consumption and its different components.

Figure 12. Components of unrecorded tobacco consumption



Source: EA study 2019

The level of illicit trade remains a source of concern

The challenge posed by the illicit tobacco trade remains as preoccupying today as it has been in the past³⁵. The study finds that illegal products account for approximately 8% of actual cigarettes consumption (see estimates in Table 2). Counterfeited cigarettes still rank as the number one category of detained articles by customs at EU external borders³⁶.

It should be noted that a more precise estimation of these trends is difficult due to the lack of validated and comprehensive data. As noted in section 4.2, estimates on illicit trade are uncertain and difficult to match. With this in mind, the European Anti-Fraud Office (OLAF) has launched a study to identify an approach to measure the illicit market for tobacco and conclusions are expected for 2020.

³⁵ Progress report on the implementation of the Commission Communication "Stepping up the fight against cigarette smuggling and other forms of illicit trade in tobacco products - a comprehensive EU strategy (Com (2013) 324 final of 6.6.2013)" (COM(2017)235 final

³⁶ Report on the EU customs enforcement of intellectual property rights, 2018

Table 2. Magnitude of illegal product consumption across EU Member States (2010-16)

| Member State | Average illegal cigarettes (bn sticks per year) | Average actual consumption (bn sticks per year) | Incidence of illegal cigarettes on actual consumption |
|--------------|---|---|---|
| AT | 0.48 | 15.22 | 3.1% |
| BE | 0.48 | 10.51 | 4.3% |
| BG | 2.49 | 14.17 | 14.5% |
| CY | 0.05 | 1.53 | 3.3% |
| CZ | 0.54 | 14.98 | 3.8% |
| DE | 4.45 | 99.19 | 4.3% |
| DK | 0.16 | 6.76 | 2.2% |
| EE | 0.32 | 1.80 | 15.1% |
| EL | 3.48 | 22.99 | 13.3% |
| ES | 3.39 | 54.65 | 5.9% |
| FI | 0.67 | 6.83 | 9.1% |
| FR | 7.23 | 62.88 | 10.3% |
| HR* | 0.19 | 6.70 | 5.0% |
| HU | 0.55 | 9.61 | 5.5% |
| IE | 0.52 | 5.07 | 9.2% |
| IT | 4.63 | 82.52 | 5.3% |
| LT | 1.00 | 3.67 | 20.9% |
| LU | 0.02 | 1.81 | 1.3% |
| LV | 0.76 | 2.57 | 22.6% |
| MT | 0.06 | 0.83 | 6.9% |
| NL | 0.89 | 13.63 | 6.1% |
| PL | 6.42 | 47.75 | 12.0% |
| PT | 0.22 | 11.24 | 1.9% |
| RO | 3.80 | 26.42 | 12.6% |
| SE | 0.57 | 6.70 | 7.9% |
| SI | 0.24 | 4.90 | 4.6% |
| SK | 0.12 | 6.95 | 1.7% |
| UK | 3.76 | 44.75 | 7.9% |
| EU | 47.48 | 586.66 | 8.1% |

(*) HR: period 2013-2016

Source: EA study 2019

A combination of legislative responses, robust law enforcement and enhanced cooperation at national, European and international levels are promoted to fight against this illicit trade³⁷. Notably the following measures are encouraged: the implementation of the World Health Organisation (WHO) Framework Convention for Tobacco Control (FCTC) Protocol to eliminate Illicit Trade in Tobacco products³⁸, to engage source and transit countries, to invest in intelligence and analysis, to focus on some key input materials (machinery, raw tobacco, filters), to raise consumer awareness regarding illicit trade, to launch targeted operations and to keep monitoring developments.

³⁷ 2nd Action Plan to fight the illicit tobacco trade 2018-2022 (COM(2018)846 final)

³⁸ <http://www.who.int/fctc/protocol/en/>

Finally, it is expected that the entry into force of the tracing system as foreseen under the Tobacco Products Directive³⁹ will impact the level of illicit trade. The EU traceability system⁴⁰ applies to cigarettes and roll your own products both manufactured in the EU as well as those manufactured outside the EU which are destined for the EU market as of 20 May 2019. As of 2024, it will apply to all tobacco products. It allows for the monitoring of the current location of a product within the supply chain, creation of a time and location record for all movements of that product (tracking), as well as identifying the past locations of a product to verifying the product's route back to its origin (tracing).

The study estimated the tax revenue losses possibly caused by trade of illegal products as shown in Table 3. The purpose is to illustrate the magnitude of the impact of illicit trade on tax revenues. This estimation is made by calculating the hypothetical revenue yield of illegal products if they were taxed in the country of consumption at the prevailing rates. This estimate serves therefore mainly as an illustration of the impact of illicit trade. The policy measures to address this problem of fraud mainly regard control enforcement, and consumer education. Additionally, there is a clear incentive to reduce price gaps with neighbouring countries and to pursue efforts to negotiate tax approximation objectives in bilateral agreements with third countries⁴¹.

Table 3. Estimated excise duty revenue loss caused by illegal cigarettes

| Member State | Excise Duty 'loss' from cigarettes (average 2010-16, EUR million) | Incidence on Excise Duty revenues |
|--------------|---|-----------------------------------|
| AT | 60 | 3.8% |
| BE | 70 | 4.3% |
| BG | 196 | 21.0% |
| CY | 6 | 3.5% |
| CZ | 45 | 2.6% |
| DE | 660 | 5.4% |
| DK | 24 | 2.4% |
| EE | 28 | 17.9% |
| EL | 397 | 17.7% |
| ES | 438 | 6.4% |
| FI | 101 | 14.0% |
| FR | 1,451 | 14.9% |
| HR | 16 | 3.1% |
| HU | 45 | 5.7% |
| IE | 145 | 14.7% |
| IT | 608 | 5.9% |
| LT | 73 | 34.1% |
| LU | 2 | 0.6% |
| LV | 61 | 39.6% |
| MT | 8 | 11.3% |
| NL | 147 | 8.0% |

³⁹ Directive 2014/40/EU of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC (OJ L 127, 29.4.2014, p. 1–38)

⁴⁰ See [the European systems of tobacco traceability and security features](#)

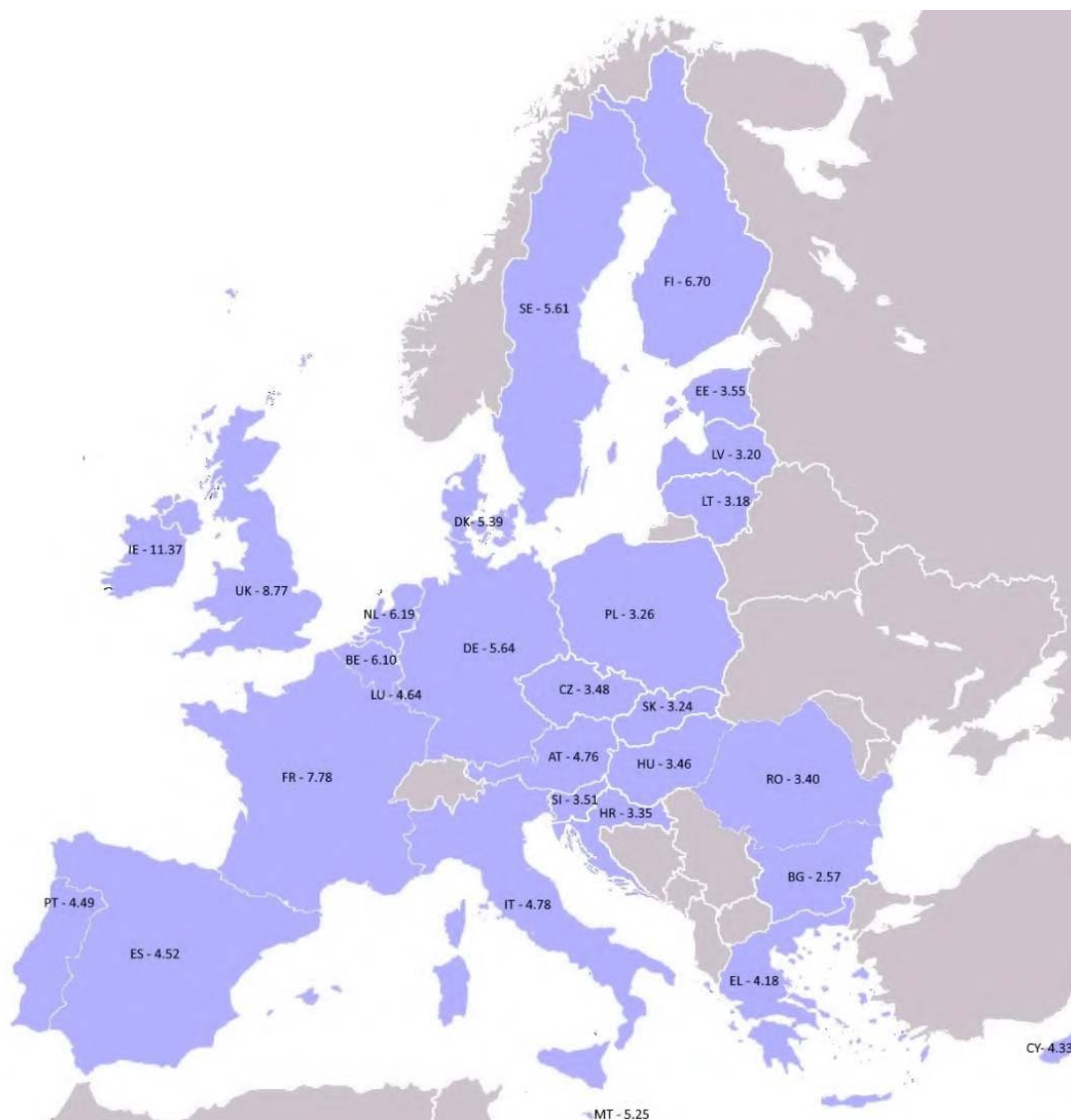
⁴¹ See the [Association Agreement](#) between the European Union and its Member States, of the one part, and Ukraine, of the other part.

| | | |
|-----------|-------|-------|
| PL | 561 | 14.1% |
| PT | 25 | 2.0% |
| RO | 324 | 18.6% |
| SE | 89 | 9.7% |
| SI | 23 | 5.6% |
| SK | 11 | 1.7% |
| UK | 1,066 | 10.4% |
| | | |
| EU | 6,683 | 9.1% |

Source: EA study 2019

Significant differences in price levels among Member States create significant tobacco control and tax revenue issues.

Figure 13. Prices of a pack of cigarettes in euro



Source: DG Taxud - Excise Duty Tables, based on Weighted Average Price, March 2019

The ‘convergence’ objective of the EU excise legislation is primarily aimed at preventing the risk that high tax differentials may generate significant flows of products from low-tax to high-tax countries with ensuing distortive effects on competition and ultimately on tobacco control targets and tax receipts of Member States. Evidently, such flows are immediately linked, if any, to price differentials rather than tax levels, but as the study notes there is a statistically significant correlation between excise duty levels and prices.

As a possible consequence of the lack of convergence in price levels between countries, the incidence of cross-border flows of duty-paid cigarettes from low-tax to high-tax countries has increased. The study estimates the EU aggregated net effects at approximately EUR 2.5 billion of revenue losses. In certain Member States this situation

causes significant concerns not only to revenue collection but also to health protection measures taken at national level.

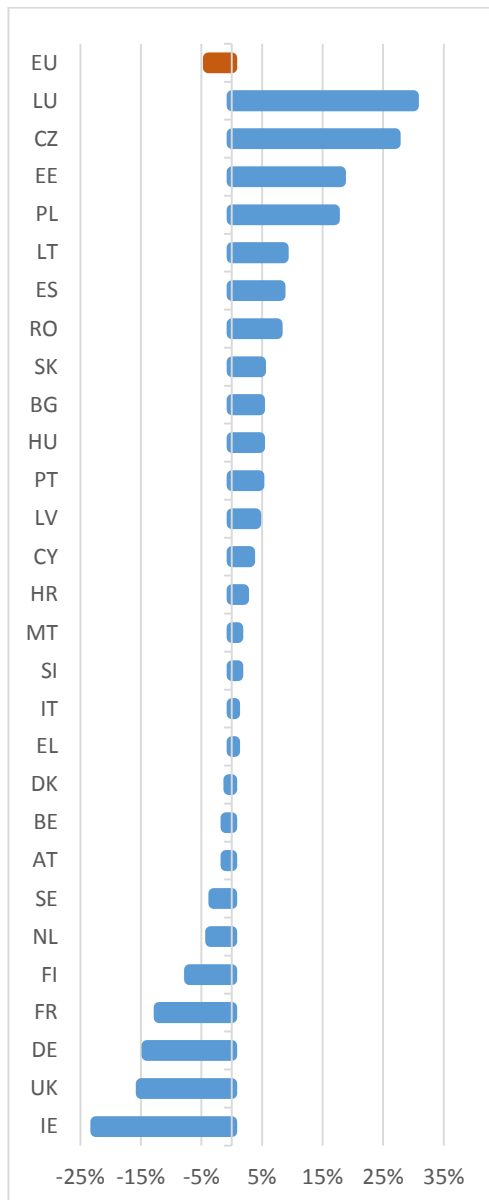
The non-domestic level (NDL) indicator used in the study reflects the share of unrecorded tobacco consumption that is taxed in a Member States that is different from the country of final consumption. In the study, the definition of NDL includes both products moved for private consumption and those moved for (illicit) reselling.

The study estimates the share of these flows that is possibly driven by economic incentives – i.e. price differences that are sufficiently high to justify not only purchases for private consumption by tourists or travellers, but also to ensure an economic profit in case of illicit reselling or travelling for the sole purpose of buying cigarettes.

In this respect, as noted in section 4.2, it is important to highlight that no valid source of data is currently available to estimate the final use of cigarettes moved cross-border, and in particular the share of cigarettes eventually intended for legitimate own consumption against those that are instead diverted to illicit reselling. So, the concept of ‘economic-driven flows’ elaborated in the study designates the subset of the total flows that contain also, but not only, products illicitly resold, while excluding the subset of those that are certainly for private use because their price in the country of purchase is similar or higher than in the country of destination.

The study notes that five Member States (Ireland, the United Kingdom, Germany, France and Finland) experience a significant revenue loss while seven Member States (Luxemburg, the Czech Republic, Estonia, Poland, Lithuania, Spain and Romania) register considerable extra revenue (see Figure 14).

Figure 14. Economic driven NDL incidence on excise duty revenue (%)



Source: EA study 2019

The findings of the study point out at the importance of cross border level indicate despite the ambition of enhanced harmonisation and convergence of taxes as envisaged in the Directive under recital 15 (‘certain degree of convergence’) and Article 7(3) (‘final stage of harmonisation’).

The rise of illicit bulk tobacco and illicit manufacturing inside the EU

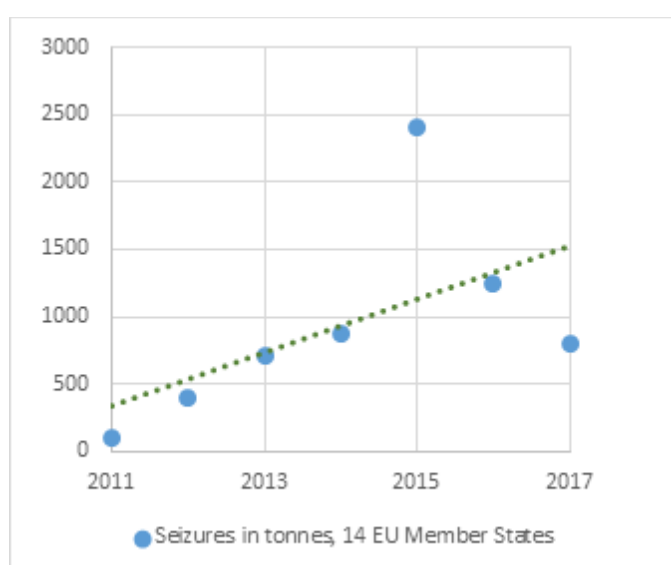
Overall the illicit trade of non-taxed cigarettes is declining in the EU, however it is reportedly on the rise for ‘bulk’ tobacco. Illegal bulk tobacco may be destined for ‘hand-rolled’ consumption, but could also be destined for the manufacture of other products (cigarettes, water-pipe tobacco, smokeless tobacco products, and snus in Sweden). The

lack of control of raw tobacco is of particular concern with evidence of increasing diversion to the illicit manufacturing of cigarettes inside the EU. The operations of illegal manufacturing sites inside the EU are of particular concerns to investigators⁴².

Experts from Member States' customs and taxation authorities confirmed this analysis in a dedicated workshop on raw tobacco⁴³. The existing reporting of tobacco production levels at national level is not sufficient to allow for the monitoring of the flows of raw tobacco across borders inside the EU⁴⁴. The need to track movements of raw tobacco once imported into the EU was also noted. In particular, the absence of a harmonised definition of raw tobacco was seen as a major limit to allow for proper cross border monitoring.

The figure below shows the quantity of seizures for 14 EU countries over the last 6 years⁴⁵.

Figure 15. Rise of the illicit bulk tobacco in the EU



Source: EA study 2019 (seizures in tonnes, 14 EU Member States)

These seizures represent for some Member States a major share of the fine-cut tobacco legal market.

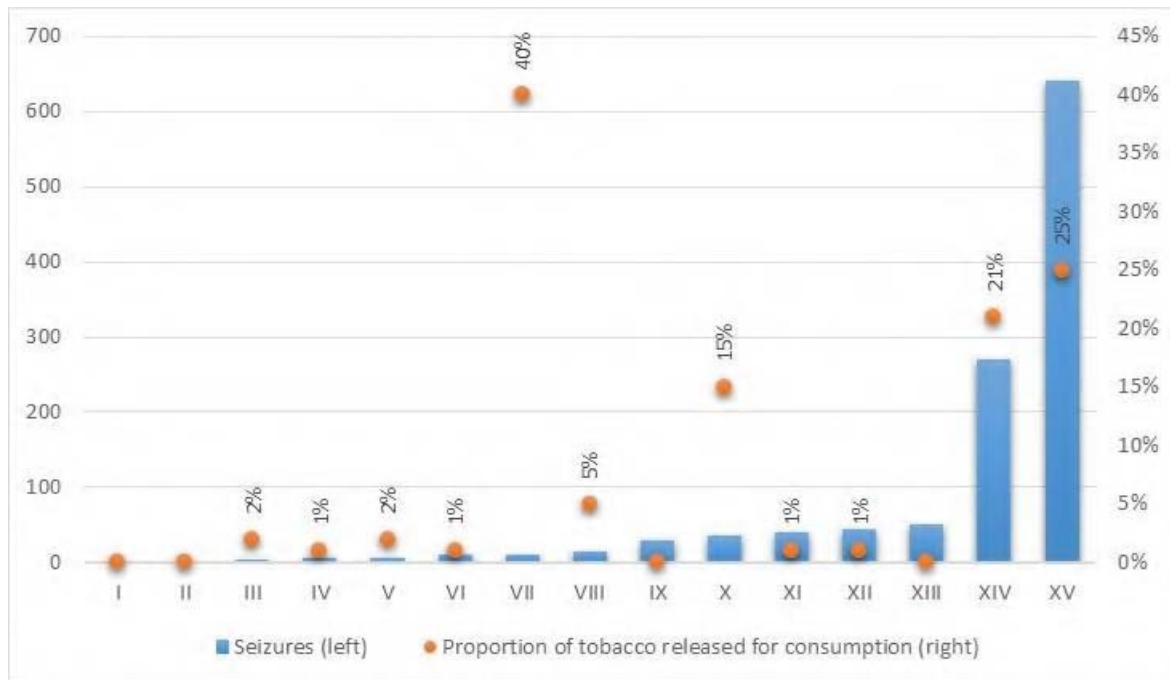
⁴² The Olaf report 2018

⁴³ Fiscalis workshop on raw tobacco with experts from Member States, Budapest, June 2019

⁴⁴ [Commission Implementing Regulation \(EU\) 2017/1185 \(notification of harvest\)](#)

⁴⁵ These countries were in a position to report such seizures. Data has been consolidated and anonymised.

Figure 16. Average seizures in 15 EU countries (2011-17, in tonnes) as a proportion of average fine-cut tobacco released for consumption.



Source: EA study 2019. Axis: EU countries (I – XV, anonymised).

Evaluation question:

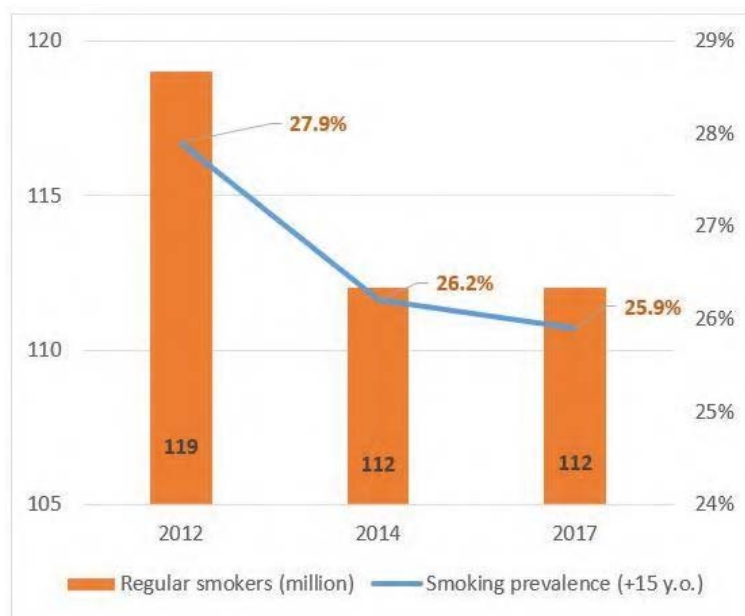
To what extent have the current minimum rates helped and supported in provide a high level of health protection?

The smoking prevalence remains high

The study found a clear decline of smoking prevalence in all the EU region. However, this decline remains far from the decline levels expected in the 2008 Impact Assessment⁴⁶ supporting the proposal for Directive 2010/12/EU amending Directives 92/79/EEC and 92/80/EEC on tobacco taxation. Its objective of a reduction of smoking prevalence by 10% over the 5 years following adoption was not met.

⁴⁶ See Commission Impact Assessment report 2008: [SEC\(2008\)2266](#)

Figure 17. Smoking prevalence in the EU



Source: EA study 2019

Overall, the study found that EU minimum rates have mainly supported public health-related impact in only a minority of Member States in Eastern Europe. The study confirms that taxation has proved to be a main driver for the reduction of smoking prevalence.

The impact of taxation on dissuading youth from smoking in some Member States has been lower than expected

An important concern in tobacco control is the smoking prevalence among the young generation. The study notes that the impact of taxation on dissuading youth from smoking in some Member States has been lower than expected due inter alia to the substitution of cigarettes with less expensive products like fine-cut tobacco or, in some Member States, with water-pipe tobacco. As noted under the previous question, there are serious concerns with the illicit trade levels for these two products. These levels jeopardise the achievement of tobacco control and health protection objectives.

The study also notes that smoking level for women 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.

Substitution to smokeless tobacco products is an issue of concern for some countries

In addition the smoking prevalence figures do not reflect the possible substitution to smokeless tobacco products and notably chewing tobaccos products in certain Nordic countries⁴⁷. This is illustrated by the low smoking prevalence figure reported in Sweden, the only country where sale of snus products is legal. Increasing consumption of snus⁴⁸ and chewing tobaccos in neighbouring countries has been reported.

Concerns with affordability levels

Affordability is the other key indicator for tobacco control. The study found that affordability of cigarettes and fine-cut tobacco has decreased in most EU countries over the last decade, primarily in connection with tax increase trends. The study nevertheless points out that the decreasing affordability trend has slowed down and even reversed in some Member States over the past three years, since the price level trend barely matched the income growth.

In addition, the affordability of fine-cut tobacco, notably linked in some countries to the development of products known as 'volume tobacco' is still an area of concern despite the progressive increase of taxes foreseen under the Directive.

Furthermore, when compared to affordability levels, the comparison between Member States reflects a significantly different view than the usual comparison based on nominal tax rates. The figure below illustrates this situation. For instance, Romania, Hungary and Poland have low nominal prices for cigarettes⁴⁹ while in purchasing power parities terms prices are actually more expensive than the EU average. Conversely, Austria, Denmark and Luxemburg feature among the least expensive countries for buying cigarettes in purchasing power parities terms⁵⁰.

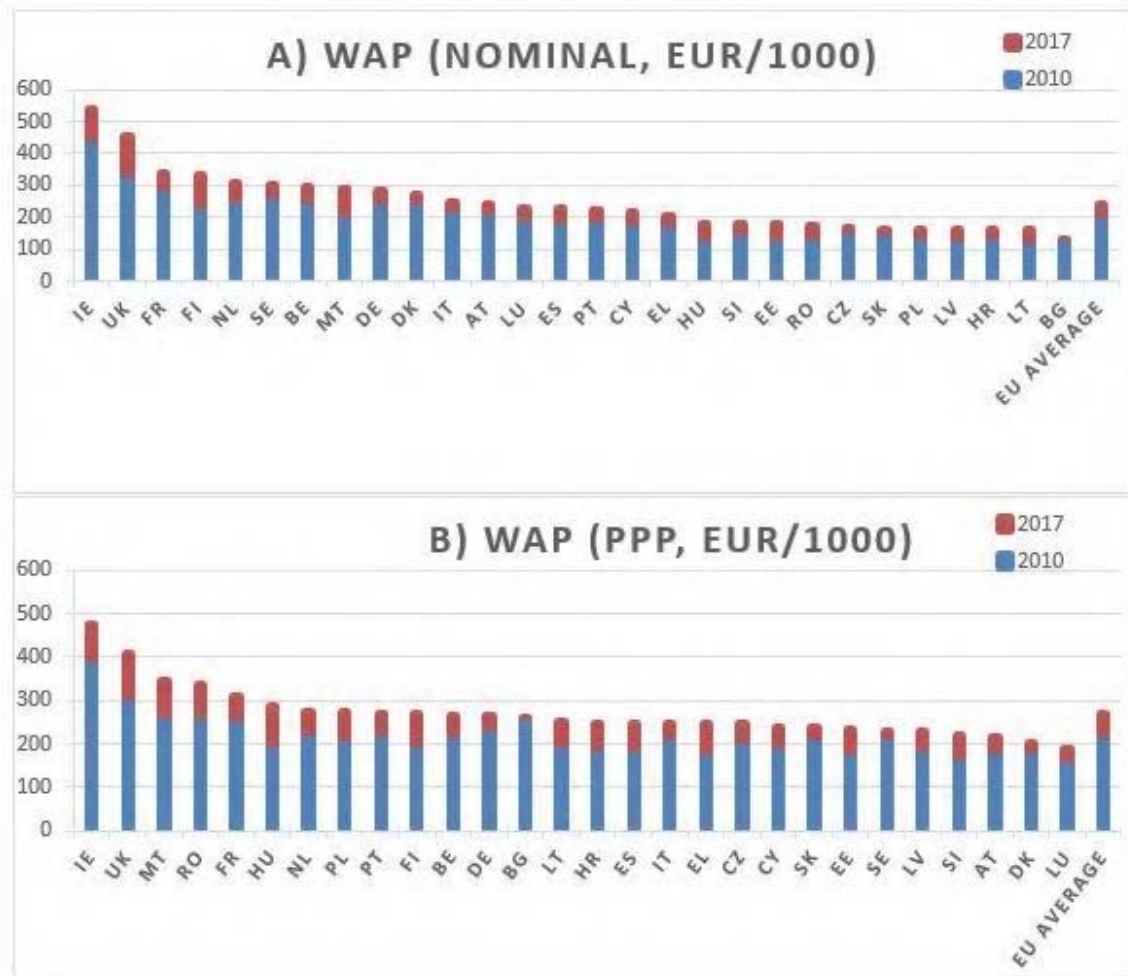
⁴⁷ A link between the decreasing use of cigarettes and the increasing use of snus is difficult to establish, but the phenomenon should be considered nevertheless.

⁴⁸ Sale of snus is illegal in all the EU except Sweden but it is legal for foreign travellers to buy snus (and carry back personally) for personal use

⁴⁹ The weighted average retail selling price is calculated as the ratio between the monetary value of all products released for consumption, based on the retail selling price, divided by the total quantity released for consumption.

⁵⁰ Purchasing power parities (PPPs) are price relatives that show the ratio of the prices in national currencies of the same good or service in different countries.

Figure 7. Affordability levels for cigarettes in the EU (EUR/ 1000 units)



Source: EA study 2019. WAP=weighted average price; PPP= purchasing power parities

5.2. Efficiency

The section on efficiency aims at studying the relationship between the resources required by a policy intervention and the changes generated by the intervention. The functioning of the Directive in terms of efficiency was assessed on the basis of the following evaluation questions.

Evaluation questions:

To what extent are the current rates and their structure cost effective in achieving the desired results? Would it be possible to achieve the same results (benefits) at less costs?

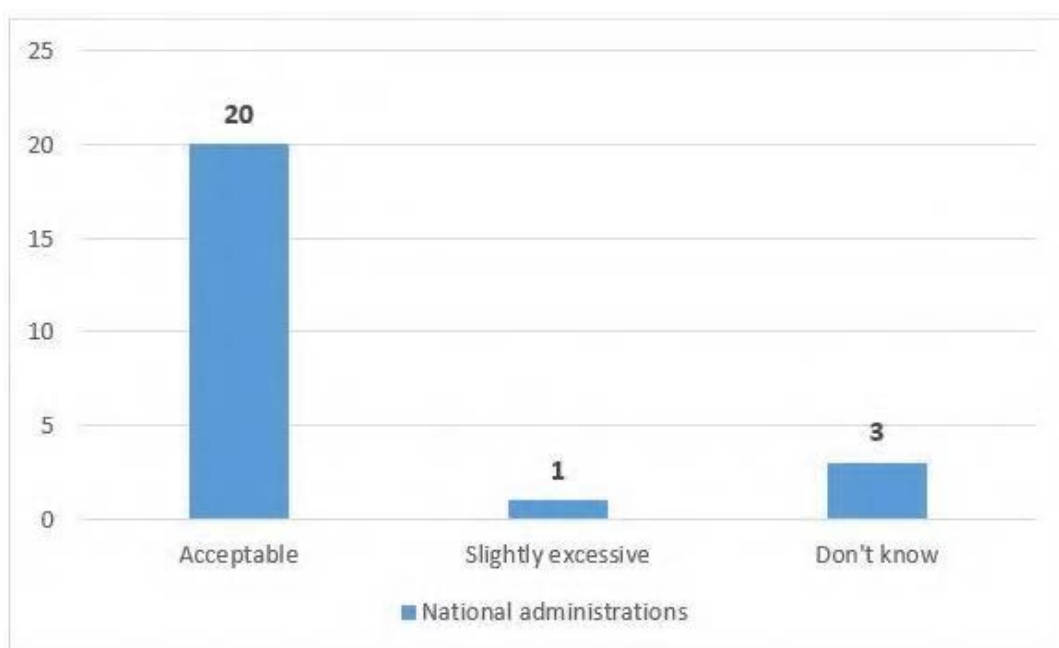
Is there potential to reduce inefficiencies or simplify the rates and structures of excise duty applied to manufactured tobacco without undermining the intended objectives?

Limited regulatory burden

The study finds that the nature and the scope of the measures introduced by the Directive has had limited impact in terms of regulatory burdens for both public authorities and economic operators. Overall, as reported in the public consultation carried out in 2018 and the interviews during the study, such burden is considered by stakeholders acceptable and has not changed overtime.

None of the tax authorities consulted was in the position to quantify the direct costs envisaged by the Directive for two main reasons: (1) they could not be extrapolated from the general functioning of the national tax administration and ordinary procedures and practices, and (2) any 'extra' cost specifically related to the Directive were nonetheless deemed negligible.

Figure 19. Assessment of regulatory burden by Member States' administrations



Source: EA study 2019 (24 national authorities responded to the questionnaire)

The regulatory burden borne by Member States authorities is actually to be seen in relation to the overall EU excise legislation (and not specifically related to the Directive). Compliance costs are mainly related to the Horizontal Directive that oversees all arrangements concerning excise systems and the movement of excise goods overall - including the Excise Movement Control System (EMCS). The costs have been analysed in 2017 in the report on the evaluation of the Horizontal Directive⁵¹.

⁵¹ COM(2017) 184 final

Legal uncertainties and room for improvement

The study notes that there is room for further improvement of the current situation addressing the legal uncertainties (and the related transaction costs) stemming from the subjective elements of the Directive. In particular, the definition of ‘smoking tobacco’ and the definition of cigarillos laid down in the Directive are a source of confusion for stakeholders as the terminology is different from that used in customs classification.

These concerns had already been highlighted in the 2015 evaluation report. Furthermore, two recent CJEU judgements⁵² addressing the definition of smoking tobacco and borderline cigarillos indicate that the uncertainty is still a source of friction.

The EU provisions have been efficient in reducing the cost of decreasing smoking prevalence

Comparing direct charges (i.e. the tax revenues) with smoking prevalence trends, it emerges from the study that the revision of EU minima introduced by the Directive has led to a slight improvement of the cost-efficiency of fiscal policy with respect to potential reduction of social costs of smoking. The study compared the actual cost-efficiency of the Directive in addressing smoking prevalence with an hypothetical scenario in the absence of the Directive by calculating an index representing the cost of one less smoker. The results confirm that the increase of the EU minimum rates have led to a slight improvement of the overall efficiency. In other words, from a public health perspective, the study concludes that EU provisions have been efficient in reducing the cost of decreasing smoking prevalence, enhancing the benefits in terms of lives saved and reduced healthcare and productivity costs.

Inefficiency of the Directive to embrace new products

Finally, the current tax categorisation is inefficient as regards the treatment of ‘heated tobacco products’ and e-cigarettes. The uncertainty on the fiscal treatment of these products with different rates and structures as illustrated in the maps below (Figure 23 and 26) creates inefficiencies and legal uncertainty. The difficulties with the cross border movements of these products result in a malfunctioning of the internal market.

For **heated tobacco products** (HTP), the growth in the number of players and commercialisation as well as disparities of treatment, affect the functioning of the EU market and cause administrative burden. The study notes in particular that the disparities of interpretation and approach may cause administrative issues in the cross-border movement of products. The choice of some Member States for an ad hoc regime affects control and enforcement, while the decision to treat HTP similar to the category of “other smoking tobacco” may constraint Member States options.

⁵² Judgment of 6 April 2017, *Eko-Tabak*, C-638/15, EU:C:2017:277; and judgment of 11 April 2019, C-638/17, *Skonis ir kvapas*, EU:C:2019:316.

Figure 20. Tax regulation of heated tobacco products in the EU (Q4 2017)

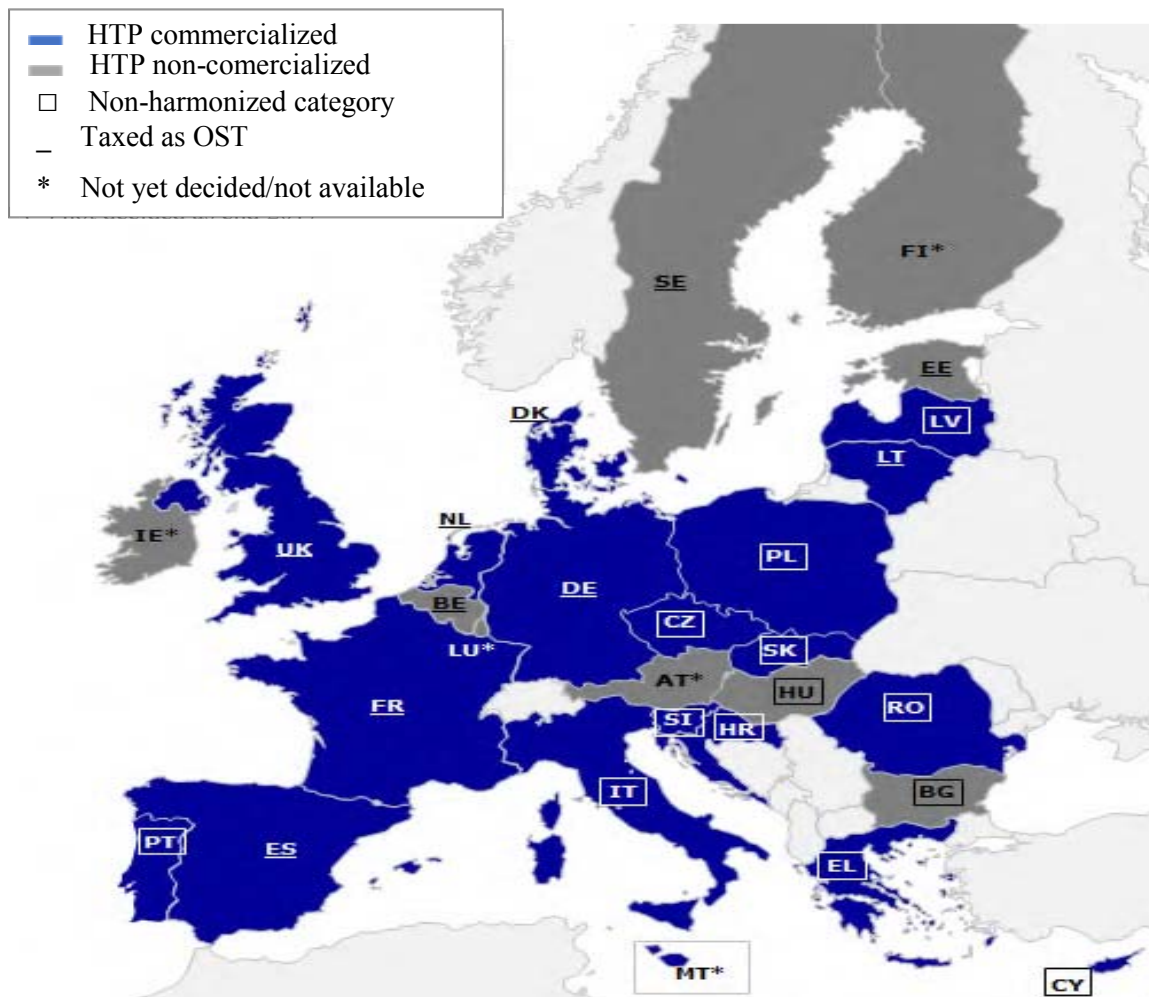
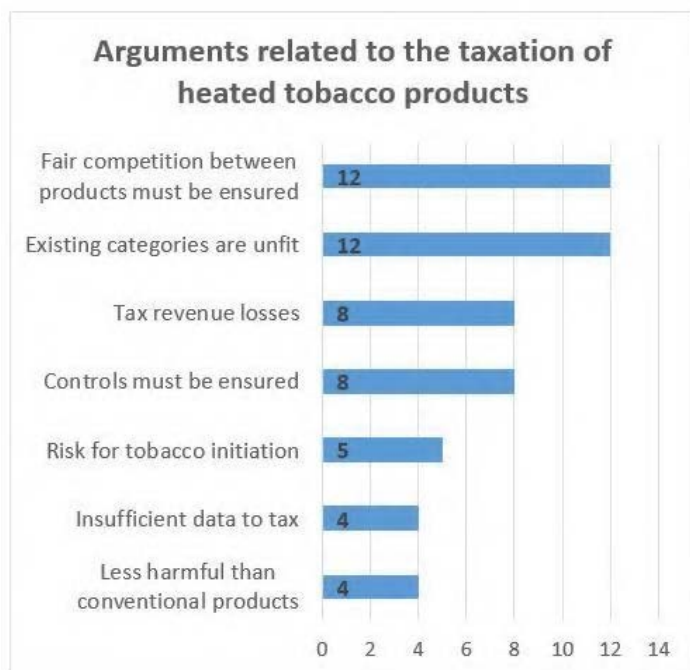


Figure 20 shows the picture of taxation of heated tobacco products as at the end of 2017. It should be noted that new products are being launched and the situation is evolving rapidly. For instance, Italy has adopted a product-specific approach by establishing an equivalence of time consumption to conventional cigarettes under the same puffing conditions and applying a 50% reduction (that will significantly reduce in the course of 2019); in Portugal there is a mixed approach with an ad valorem component, a specific component and a minimum excise; Hungary has a fully specific non harmonised tax per items (and not per weight).

Other countries apply the tax regime of other smoking tobacco (per weight in Kg, or a mixed structure). The United Kingdom has created in 2019 a separate tax category for HTP with a rate identical to fine-cut tobacco. The Czech Republic, Lithuania and Slovenia have also implemented a specific tax and apply rates corresponding to the level applied to fine-cut tobacco. Poland has also created a specific tax, with a mixed structure to be applied from July 2020.

The level of fragmentation is high and the lack of harmonisation is creating significant obstacles to the smooth functioning of the internal market.

Figure 21. Answers of national administrations in relation to heated tobacco products



Source: EA study 2019, total number of respondents 24, multiple choices possible.

The feedback from Member States during the study indicates that most Member States prefer an EU-level harmonisation, with most Member States favouring a new category in the Directive so as to reduce the administrative burden caused by the current highly fragmented legal and classification approaches between Member States.

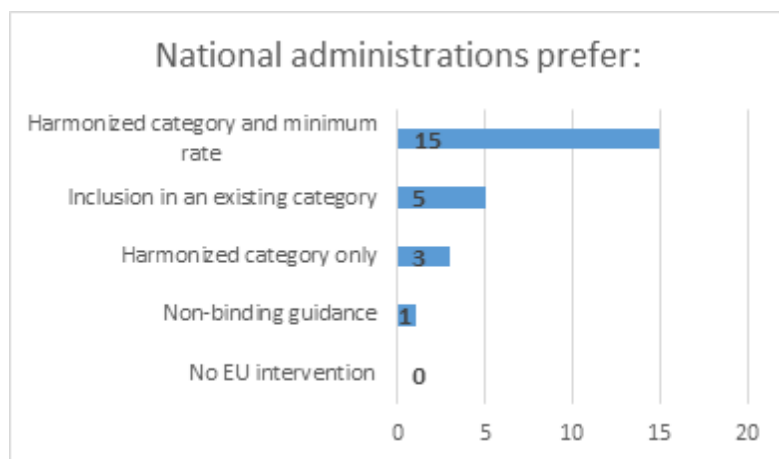
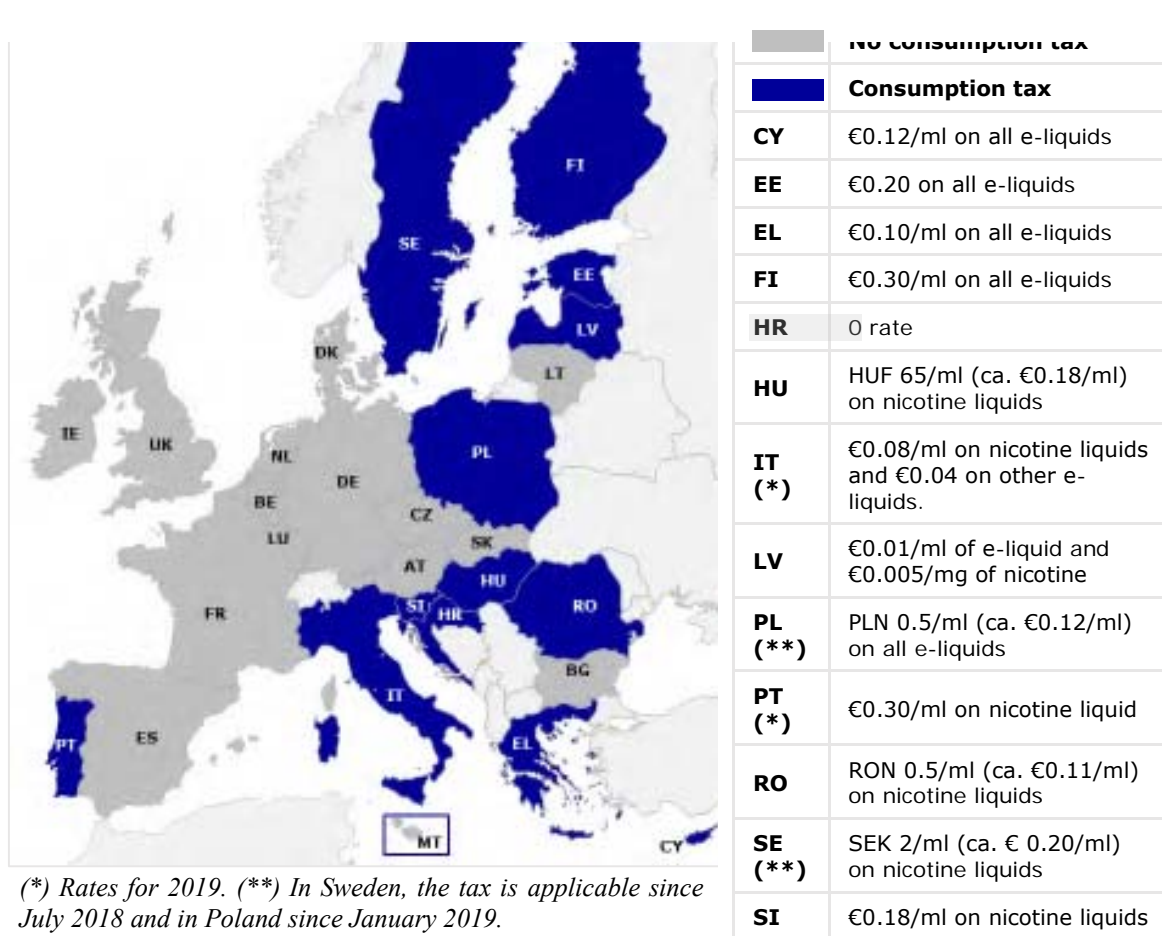


Figure 22. Answers of national administrations possible ways forward

Source: EA study 2019, total number of respondents 24, several answers possible

For **e-cigarettes**, each taxing country has created its own tax regime and implementing measures resulting in a significant fragmentation of rules across the EU. Moreover, control of cross-border online sales is difficult.

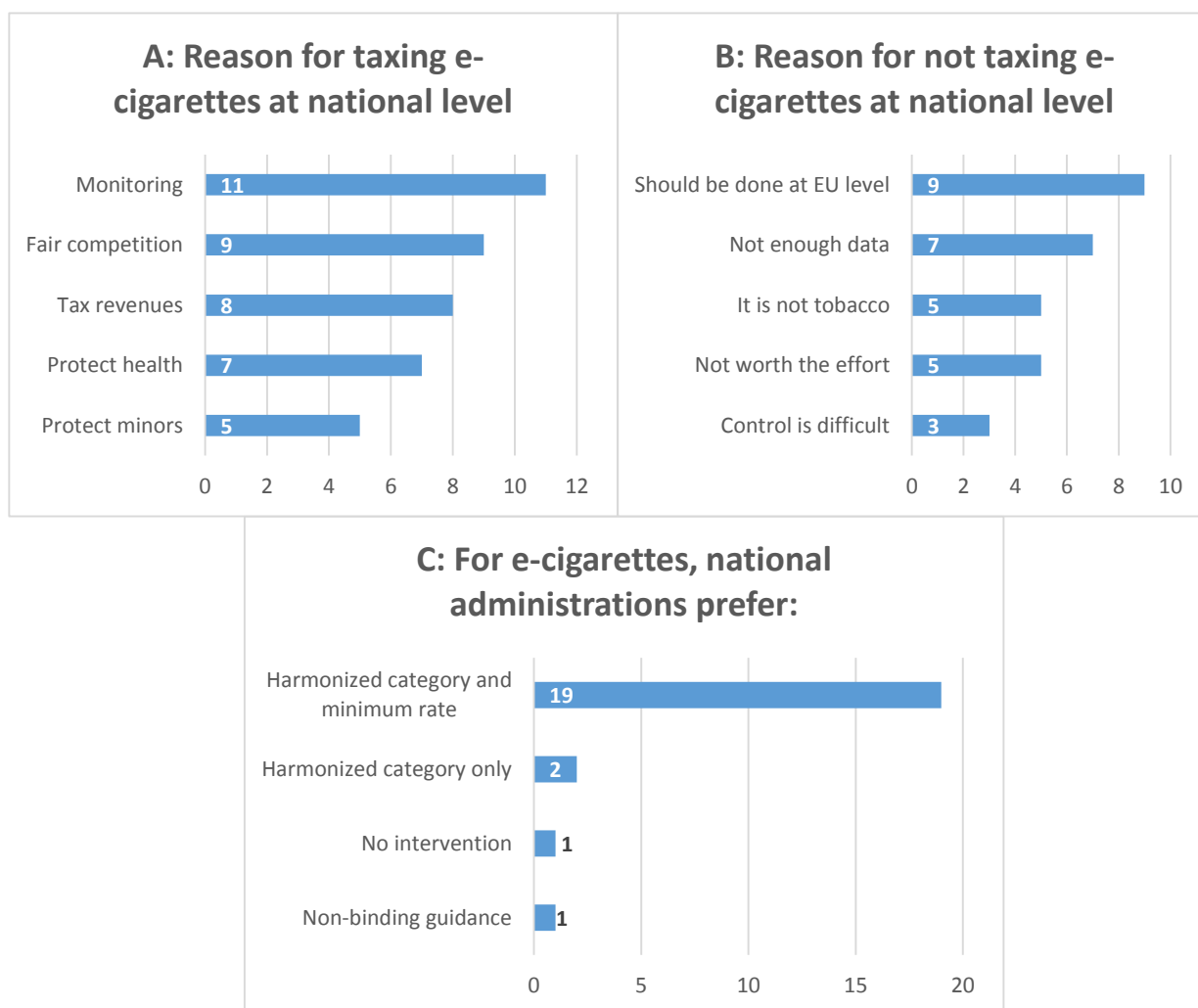
Figure 8. National, ad hoc tax regimes for e-cigarettes in the EU4 2017)



The situation is evolving regularly reflecting market and regulatory developments. For example, Lithuania introduced an excise duty for electronic cigarette in 2019 (0.12 EUR per millilitre of product).

The feedback from Member States during the study indicates a strong preference for EU level harmonisation for the tax regime of e-cigarettes as different regimes prevent monitoring and control of cross border trade.

Figure 9. Replies of national administrations on e-cigarettes consultation



Source: EA study 2019. 11 national administrations answered to the first question (those who were taxing e-cigarettes at the moment of the survey), 12 national administrations answered to the second question, and 23 national administrations replying to the survey answered the third question.

5.3. Coherence

External coherence looks at how well the Tobacco Excise Directive is integrated and compatible with other related EU policies, most notably tobacco control policies and further policy developments and international agreements in place. This section also analyses the internal coherence of the Directive looking at how the various provisions of the Directive operate together to achieve its objectives.

The functioning of the Directive in terms of external coherence was assessed on the basis of the following evaluation question:

Evaluation question: Are the rates and structures of excise duty applied to manufactured tobacco coherent with other EU policies and international obligations?

As indicated in section 1, the Directive is part of a broader EU policy framework that includes among others the EU excise and customs framework with the general excise duty legislation and the customs union legislation, tobacco control policies and notably the Tobacco Product Directive, and the policies against illicit trade and tax fraud. Additionally, the EU is party to the WHO Framework Convention on Tobacco Control where tax measures play a major role.

Coherence between the EU excise and customs framework could be enhanced

The results of the study indicate that the Directive is broadly coherent with the overall principles and policies governing the Single Market.

A possibility to enhance the coherence between the EU excise and customs framework could be further explored. As already seen in previous evaluation reports, the study highlights again the opportunity to fix issues concerning the definitions of ‘smoking tobacco’ and ‘cigarillos’. It should be noted that contrary to other excise goods, there is no reference in the Directive to the Combined Nomenclature (CN classification) used for customs purposes. In some cases this actually might give rise to the application of different terminology as reported under the efficiency section.

The negative impact of cross border traffic and the necessity to ensure coherence with the Horizontal Directive

As seen under the effectiveness criteria, the level of cross border traffic has a significant impact on excise duty revenues, notably for some Member States. In addition, for particular flows the abnormal level of trade can put at risk the public health objectives adopted by some Member States.

The scope of the tobacco tax Directive does not cover the levels of cross border traffic. However, the lack of convergence of taxes (hence prices) and the resulting importance of

trade for some bi-lateral flows questions the coherence with Article 32 of the Horizontal Directive on cross-border acquisitions by private individuals.

The general rule is that excise duties are applied in the country of release for consumption. As derogation from this general rule, and in accordance with the principle governing the internal market, Article 32 of the Horizontal Directive establishes that in the case of excise goods acquired by a private individual for his own use, and transported from one Member State to another by him, the excise duty of the country of purchase applies.

The Horizontal Directive provides criteria that Member States should at least take into account to determine whether the goods are for the private individual's own use:

- the commercial status of the holder of the excise goods and his reasons for holding them;
- the place where the excise goods are located or, if appropriate, the mode of transport used;
- any document relating to the excise goods;
- the nature of the excise goods;
- the quantity of the excise goods (Member States cannot set guide levels below certain quantities indicated in Article 32(2) of the Horizontal Directive).

The transitional period foreseen in Article 10(2) of the tobacco tax Directive allowed some Member states a delay to reach the minimum overall excise duty levels for cigarettes. To accommodate for the imbalance during that period, where the minimum excise was not reached, a transitional measure was introduced in the Horizontal Directive under the repealed Article 46(3)⁵³ to allow for the restriction of the amount of tobacco that travellers could bring for private use from these countries under derogation to the rest of EU. The stricter restrictions were designed to mitigate the risk of possible adverse effects on cross-border flows of products. These restrictions have been lifted since 1st January 2018, with the end of the transitional period.

Yet the divergence in tax levels remains high, and therefore the potential for high level of cross border flows derogating to the general principle of excise duty to be paid in the country of consumption.

As already seen under the effectiveness evaluation criteria, excise duty convergence envisaged by the Directive is far from becoming a reality and considerable divergence between Member States remain creating an incentive for economic driven non-domestic purchases. The prices differences are sufficiently high to justify not only purchases for private consumption by tourists or travellers but also to ensure an economic profit in case of illicit reselling or travelling for the sole purpose of buying cigarettes.

⁵³ During that period, affected Member States could apply a quantitative limit of no less than 300 cigarettes rather than of 800 cigarettes.

An external study on the implementation of Article 32 and 36 of the Horizontal Directive is underway. This study will notably look at the acquisition and movements of duty-paid products by private individuals, including tobacco products.

The emphasis on the public health objective and synergies with tobacco control policies deserves better attention

A previous revision of the tobacco tax Directive in 2002 already referred to public health as an objective. Although the public health is one of the two main goals explicitly mentioned in the current Directive, the historical focus of the tobacco tax Directive was still seen as primarily relating to the proper functioning of the single market.

The emphasis on the public health objective deserves better attention as taxation is recognised as the most effective tool to influence behaviour regarding the use of tobacco products.

As for the overall alignment with the WHO policy, the Directive has taken up the Framework Convention on Tobacco Control guidelines' recommendations on effective tax policies. However, the overall excise tax targets that the WHO recommends (an overall excise duty share of 70% of the retail price for tobacco products) may still be challenging. In addition, the alignment and coherence should be seen in perspective of the ambitious (and voluntary) WHO target of 30% of reduction by 2025 of smoking prevalence.

There is room for further integration and synergies with other tobacco control policies notably public health policies and the fight against cancer, and the policies against illicit trade and tax fraud.

Recent policies adopted in Finland, France or the Netherlands are examples of coherent tobacco tax policies are designed as part of a coherent package of tobacco control policies.

The Finnish law on Excise Duty on Tobacco ⁵⁴ refers to health objective in the Article 1 of the law: “The purpose of the tobacco excise is to promote, among other things, the goals for which it is prescribed in the Tobacco Act”. Article 1 of the referred Tobacco Act ⁵⁵ reads: “The purpose of this law is to stop the use of tobacco products and other nicotine-containing products that contain toxic substances for humans and cause dependence”.

The law on excise duty on tobacco has as objective to lower the consumption of tobacco products (total and not only domestic sales), meaning for example optimizing from this perspective the level of taxation and the tax structure of each tobacco product.

⁵⁴ [Finnish law on Excise Duty on Tobacco](#)

⁵⁵ [Tobacco Act](#)

The coalition agreement of the Dutch government made in 2017 explicitly states "We support the goal of creating a smoke-free generation and will therefore increase excise duty on tobacco."⁵⁶ A national prevention agreement ("Nationaal Preventieakkoord")⁵⁷ was then concluded in November 2018 between various partners and the Ministry of Health on the prevention of smoking, obesity and problematic alcohol use. With respect to tobacco, the goal of the agreement is to have a "smoke-free" generation in 2040. One of the planned measures mentioned in the agreement concerns the excises on tobacco foreseeing regional coordination with neighbouring countries to address the risk of increase cross-border shopping.

The French government announced in June 2017 its political ambition⁵⁸ to reduce tobacco smoking and bring the price of a pack of cigarettes to 10 Euro. In parallel, as a safeguard, it insisted on the need to fight fraud. The 2018 law⁵⁹ for financing the social security foresees five stages of tax hike to increase prices.

Coherence with the Tobacco Product Directive to be further fine-tuned

Since the adoption of the Directive, a number of regulatory changes happened, notably with the entry into force of the second Tobacco Products Directive⁶⁰. The Tobacco Products Directive aims to improve the functioning of the internal market for tobacco and related products, while ensuring a high level of health protection for European citizens. The Directive entered into force on 19 May 2014 and became applicable in the EU Member States on 20 May 2016.

The Tobacco Products Directive lays down rules governing the manufacture, presentation and sale of tobacco and related products. These include cigarettes, roll your own tobacco, pipe tobacco, cigars, cigarillos, smokeless tobacco, electronic cigarettes and herbal products for smoking. The overall objective of the Directive is to facilitate the smooth functioning of the internal market for tobacco and related products, to ensure high level of human health protection, especially for young people, and to meet the obligations of the Union under the WHO Framework Convention for Tobacco Control. In this respect the goal of the tobacco product Directive is to reduce the numbers of tobacco users with a particular focus on discouraging young people from taking up smoking and to ensure that citizens across the EU are fully aware of the harmful effects of tobacco use.

Notably new definitions of tobacco products have been introduced and coherence with definitions in the taxation Directive would need to be further fine-tuned.

⁵⁶ [Dutch coalition agreement](#)

⁵⁷ [Dutch national prevention agreement](#)

⁵⁸ [Prime Minister 2017 general policy statement](#)

⁵⁹ [Finance act of December 2018](#)

⁶⁰ Directive 2014/40/EU of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC (OJ L 127, 29.4.2014, p. 1–38)

Another key element of the Tobacco Product Directive is the introduction of an EU-wide tracking and tracing system for the legal supply chain. This system with a security feature composed of visible and invisible elements (e.g. holograms) aims to help law enforcement bodies, national authorities and consumers detect illicit products.

The entry into force of the track and trace system for cigarette packs and roll-your-own in 20 May 2019⁶¹ call for continuing to ensure the coherence between the regulatory frameworks, and notably the Excise Movement Control System (EMCS). In particular, the modern track and trace system can contribute to effective controls as envisioned by the Customs Union framework and will also assist in the global fight against tax fraud.

Under the traceability system, all unit packets of tobacco products are required to be marked with a unique identifier. It will be possible to track and trace the movement of legal tobacco products to allow public authorities to determine when a product was diverted into the illicit market.

Large room for strengthening synergies with policies to fight illicit trade

As regard coherence with illicit trade, the study notes that there is limited explicit cross-references between the Directive and the EU policy against illicit trade and tax fraud. There is significant room for strengthening connections and synergies. The study also notes the need to deepen the analytical part of the impact of taxation on illicit trade with robust independent data.

The parties to the Framework Convention on Tobacco Control adopted in November 2012 a Protocol to Eliminate Illicit Trade in Tobacco Products. This Protocol builds on Article 15 of the Framework Convention and sets the rules for combating illegal trade through control of the supply chain and international cooperation.

The introduction of the Track and Trace system for cigarettes in May 2019 is expected to contribute to a better monitoring of the flows of cigarettes. However the upstream part of the supply chain (i.e. from raw tobacco to the manufacturing site) is left without effective control. The lack of control of the supply chain notably for raw tobacco and the risk of fiscal evasion due to the growing illicit production of cigarettes within the EU remains a constant problem.

This analysis was further confirmed in a dedicated workshop on raw tobacco with experts from Member States⁶². As noted above under the section on effectiveness, there was a general consensus among experts from customs and taxation authorities on the high level of illicit trade of bulk tobacco, the increase illicit manufacturing activities, and the active presence of organised crime organisations in this area.

⁶¹ See [tracking and tracing systems](#). The system for all other tobacco products is planned for 2024.

⁶² Fiscalis workshop on raw tobacco with experts from Member States, Budapest, June 2019

Experts noted that flanking measures should be designed in parallel to the adoption of tax policies to take into account the needs and challenges of effective control and enforcement notably through education policies, resources for enforcement efforts and coordination at regional level.

Coherence with environmental policy

At global level, finally, the environmental impact of tobacco is also getting more attention and the World Health Organization published recently a study on tobacco's environmental footprint across its entire supply chain⁶³. The study concludes that every stage in the global tobacco supply chain involves considerable resource inputs, and results in the production of wastes and emissions. The environmental damage that tobacco cause makes it incompatible with the global development agenda.

The European Commission has identified tobacco filters among the top five most common pieces of litter found on beaches⁶⁴. With the adoption of the single use plastics Directive and the introduction of an Extended Producer Responsibility scheme manufacturers are expected to cover the costs of waste management and clean-up, as well as awareness raising measures for tobacco products with filters (such as cigarette butts). The single use plastics Directive⁶⁵ also foresees that Member States should promote a wide range of measures to reduce litter from post-consumption waste of tobacco products with filters containing plastic.

Coherence within the tobacco taxation Directive

Internal coherence between provisions in the Directive has already been highlighted in previous reports⁶⁶. For example 'borderline' cigarillos which have some characteristics similar to cigarettes (e.g. dimension, filter, packaging, etc.) but can be sold to a much lower price thanks to a more favourable tax treatment.

Other issues to be addressed are the uncertainty around the implementation of the Minimum Excise Duty (MED) and the calculation and reporting of the Weighted Average Price.

The MED provisions appear to be not always coherent with other provisions of the Directive. There is no ceiling to the MED, but there is an obligation to respect the 'mixed structure' requirements. However, this provision is interpreted differently between Member States leading to non-uniform views and practices concerning the upper limit of

⁶³ [An assessment of tobacco's global environmental footprint, WHO FCTC Global Studies Series 2018](#)

⁶⁴ [single use plastics impact assessment](#), SWD(2018) 254 final

⁶⁵ [Directive \(EU\) 2019/904 \(OJ L 155, 12.6.2019, p. 1–19\)](#)

⁶⁶ See Commission Report COM(2015)621 final and Commission Report COM(2018)17 final

the MED. The discrepancy in the interpretation of MED provisions is potentially distortive for the functioning of the internal market.

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. As noted in the Commission 2018 report, clarification may become necessary to allow Member States to make use of this provision against low price cigarettes in a more efficient manner⁶⁷.

The lack of internal coherence between the requirement for Member States to apply an overall excise duty of at least 60% and the provisions leading to its calculation has been a source of confusion. Article 10(2) of the Directive stipulates that the overall excise duty on cigarettes must represent at least 60% of the weighted average retail selling price (WAP)⁶⁸. However, Member States have until 1 March of each year to calculate the WAP and where the rise of the WAP results in a decrease of the excise duty below the 60% minimum requirement, the discretion left to Member States to delay the change of the rates under Articles 11(1) and 18(2) can lead to a recurrent situation where a Member State actually complies only for a short time each year with the 60% requirement.

Finally, the reporting system in view of the requirement of Article 19 of the Directive could be made more consistent with the arrangements foreseen by the implementing regulation as regards data to be reported by Member States to the Commission⁶⁹. The information collection on the national implementation of the Directive is important to ensure that the Commission has sufficient information on the national tobacco taxation structures for monitoring and assessing its performance in the future.

As noted in the study, there is room to improve the monitoring of market developments. It is important to ensure a more coherent and consistent reporting of market data and statistics. The provision of the current requested data should be timely and further consideration should be given to expanding the data that must be provided.

5.4. Relevance

This section of the analysis aims to analyse the current needs of Member States (tax administrations and public health authorities), economic operators, NGO's and citizens compared to the objectives the Directive was designed to address. The 'relevance' of the EU minima regards the extent to which the rates laid down in the Directive are (still) able to produce an effect on the excise duty levels applied in Member States, thereby

⁶⁷ See Commission report COM (2018)17 final

⁶⁸ Member States which levy an excise duty of at least EUR 115 per 1 000 cigarettes need not to comply with the 60% requirement.

⁶⁹ Commission Implementing Decision of 28 July 2011 concerning the list of statistical data on the structure and rates of excise duty applied on manufactured tobacco to be provided by the Member States pursuant to Council Directives 92/79/EEC and 92/80/EEC

contributing to the overall policy objectives. The functioning of the Directive in terms of relevance was assessed on the basis of the following evaluation questions.

Evaluation questions:

Do the current minimum rates and structures still correspond to the objectives of the Directive? Do they correspond to the needs of the national tax administrations, ministries of health and subsequently of other stakeholders (economic operators, NGO's and citizens)?

The EU minima rates have lost their traction

The minimum rates laid down in the Directive have not or limitedly changed over some few years and have therefore lost their traction on most of Member States fiscal policies. Since 2018, most Member States have reached the prescribed minimum tax levels so the current provisions have become of little relevance for the way forward. The only partial exception regards fine-cut tobacco for which the last stage of increase of EU minima is scheduled in 2020.

Similarly, provisions for the excise structure are based on the original design of the EU tobacco taxation framework in the seventies and have progressively lost their relevance. The policy objectives underlying convergence in tax rates and harmonisation of structures between Member States should be reconsidered, since they might no longer correspond to countries priorities for the near future. In addition, they appear to be irrelevant in view of the high levels of cross border shopping as noted above.

On all these matters the external study notes that the positions of stakeholders are not univocal, in particular not all tax authorities consider the current minima as outdated, and a few of them do not find the status of novel products as problematic. This is also the position of the majority of economic operators, whereas the majority of public health stakeholders conversely consider the current provisions as no longer useful.

As for the relevance of the overall impact of excise duty, the 'total tax burden' (TTB) indicator, which is the tax applicable at the weighted average price level(WAP), inclusive of VAT may provide a more realistic picture of the tax incidence on price in a comparative perspective. The total tax incidence ranges from as low as 69% in Luxemburg up to 87% in Greece and 86% in Finland.

The study notes that 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). Still, the EU minima for these products have not changed for many years and have therefore become irrelevant for almost all Member States due to inflation and income growth.

The Directive is not fit for market developments

Another dimension where the Directive seems no longer ‘fit for purpose’ is the unclear status of novel products, namely for heated tobacco products and e-cigarettes (see also efficiency section).

In the same way, the current scope of the Directive cannot address the development of the next generation of products already coming into the market. These addictive products can be substitute to cigarettes and contain nicotine or cannabidiol (CBD), notably used in e-liquids intended to be smoked for recreational purposes, regardless of whether it is synthesised or extracted from plants.

The lack of a proper definition and classification in the tobacco tax Directive of heated tobacco products and e-cigarettes, and in the future for next generation products is becoming an issue. Apart from potential substitution and possible concerns of lost revenues, this lack of harmonised definition and classification limits the possibilities of monitoring and controls. Monitoring is needed to enable verification and authentication of these products as well as the possibility to identify illicit trade, evasion and abuse in the internal market.

5.5. EU added value

This evaluation criterion examines the developments that have resulted from EU policy intervention represented by the tobacco tax Directive, compared to what could have been delivered by national actions of Member States or no action. The functioning of the Directive in terms of EU added value was assessed on the basis of the following evaluation questions.

Evaluation questions:

What is the additional value of the minimum rates and structures of Directive 2011/64/EU, compared to what could have been expected from Member States acting on national level?

Is EU intervention in this area still justified?

The study finds that the revised EU minima have raised cigarettes and fine-cut tobacco price levels in some Member States more than what would have happened in the absence of the Directive. Such additionality was greater for the fixed minimum amount requirement than for the overall minimum impact requirement. However, such effects appear of fairly limited magnitude and regard only a few EU countries.

By consequence, the study concludes that the Directive has contributed to reducing the consumption of tobacco products and smoking prevalence in the EU, although the extent of such contribution is limited (some 0.25 million fewer smokers in the 2011-17 period).

Coherently, most public health authorities of the Member States are not satisfied with the impact of the Directive on tobacco control targets and call for bolder fiscal measures.

Table 4. Public health authorities' satisfaction with the effectiveness of the Directive (shortcomings)

| A) Question: If trends were not in line with expectations / policies or plans, please indicate whether this was mostly due to taxation or other factors | | B) Question: If insufficient taxation was a cause of unsatisfactory reduction of smoking prevalence, to what extent can this failure be attributed to ineffective EU excise legislation? | |
|--|---|---|---|
| Unsatisfactory results were mostly caused by insufficient taxation | 1 | High extent | 2 |
| Unsatisfactory results were partly caused by insufficient taxation | 9 | Moderate extent | 5 |
| Unsatisfactory results were mostly caused by factors other than taxation | 0 | Modest extent | 2 |
| | | Not at all | 0 |
| Don't know | 1 | Don't know | 1 |

Source: EA study 2019 (15 national public health authorities responded to the questionnaire)

The position of tax authorities is mixed: on the one hand there is a general recognition of the added-value of the EU tobacco excise legislation and the need to maintain it, on the other hand there is at the moment no consensus on convergence of price levels and cross-border shopping.

Table 5. Public health authorities' satisfaction with the effectiveness of the Directive (results achieved)

| Question: One of the main objectives of the EU tobacco excise legislation is to reduce differences in the tax regimes applied to tobacco products across Member States. How do you rate the results achieved in this respect in the period 2011-2017? | Very significant | Quite significant | Somehow significant | Not significant | Don't know |
|--|-------------------------|--------------------------|----------------------------|------------------------|-------------------|
| Reduction of differences in tax levels of cigarettes across the whole EU | 1 | 5 | 8 | 10 | 0 |
| Reduction of differences in the tax levels of cigarettes in your country's geographical region | 3 | 5 | 5 | 6 | 3 |
| Reduction of differences in the tax levels of fine-cut tobacco in your country's geographical region | 2 | 5 | 6 | 6 | 3 |

| | | | | | |
|---|---|----|----|---|----|
| Harmonisation of excise duty structures for cigarettes (the mix of ad valorem and specific component) | 3 | 6 | 7 | 5 | 3 |
| Harmonisation of excise duty structures for other tobacco products | 2 | 4 | 10 | 4 | 4 |
| Coherence in the classification of tobacco products across the EU, based on the harmonised categories | 2 | 11 | 5 | 4 | 2 |
| Harmonisation of tax collection mechanisms | 3 | 7 | 2 | 2 | 10 |

Source: EA study 2019 (24 national tax authorities responded to the questionnaire)

6. Conclusions

Based on the evaluation criteria examined in the previous chapter, the conclusions can be summarised as follows:

- As for **effectiveness**, the overall benefits on market functioning (including substitution of fine-cut tobacco) have reduced overtime.

As regards the objective to ensure the proper functioning of the internal market, The Directive provisions on minimum excise rates have been moderately effective in raising tax rates and prices in Member States.

There is no ‘convergence’ of tax levels, but the EU minima helped to avoid an even greater disparity across the EU.

The lack of convergence in rates across the EU generates in some cases high levels of unintended cross-border flows. This lack of convergence is to be seen together with the difficulties of enforcing the concept of personal use as foreseen by Article 32 of Directive 2008/118/EC (guidance to what quantity of excise good a private person can transport over the border for its own use). The loss of tax revenues is significant for some Member States while others register considerable extra revenue compared with local consumptions. In addition, this is a major concern to the public health objectives adopted by a number of Member States.

The relative level of illicit trade has slightly declined over the years but remains substantial and a source of concern which calls for increased synergies with enforcement policies. The deviation of raw tobacco to illicit manufacturing within the EU is a growing concern for most Member States.

As regards the objective to reach a high level of health protection, the Directive contributed to the decline of smoking prevalence but only to a certain level and the smoking prevalence levels remain higher than expected.

- As regards **efficiency**, the consultation with stakeholders indicates that the regulatory burden is not an issue for Member States authorities nor for operators. Compliance costs are actually mainly related to the Horizontal Directive that oversees all arrangements concerning excise systems and the movement of excise goods overall. None of the tax authorities consulted was in the position to quantify the direct costs envisaged by the Tobacco Tax Directive. There remain however legal uncertainties that would need to be addressed including the definition of smoking tobacco or the Minimum Excise Duty.
- As for **coherence**, it can be concluded that Directive 2011/64/EU is generally coherent with international policies (i.e. Framework Convention on Tobacco Control). However, as regards coherence with other EU legislation, there is significant room for improving synergies, notably with the public health framework

and the fight against illicit trade. Finally, the lack of internal coherence among some provisions of the Directive is a source of concern.

- The **relevance** of the Directive has diminished overtime and is no longer fit for purpose. The EU minima remain have now lost their traction effects which would contribute to a more ambitious achievement of the objectives of the Directive (public health and upwards convergence). The current provisions (minimum rates, structures, and tax categories) are therefore no longer relevant to address future challenges, in particular, for products such as e-cigarettes and heated tobacco products, and the new products coming into the market.
- As for the **EU added value**, the contribution to harmonising fiscal classification of products so far has been important. However, the direct contribution on tobacco control appears limited and most public health authorities of the Member States are not satisfied with the impact of the Directive on tobacco control targets and call for stronger fiscal measures.

In view of the above findings and in particular the lack of effectiveness, relevance and coherence of the Directive, the main challenges with the implementation of the Directive are:

- **Re-conciliating the key objectives of the Directive:**

The main challenge emerging from the evaluation of the Directive is the (re)conciliation of its two main objectives “to ensure the functioning of the internal market and at the same time a high level of health protection”. The main source of confusion lies with the ambivalence between the so-called internal market objective and the public health objective. The disparity of taxes (hence prices) is allowing for a very lucrative and easy trade of cheaper tobacco products across borders inside the EU. This is not what was intended under the Directive objective “to ensure the functioning of the internal market and at the same time a high level of health protection”.

As seen above, it would be illusionary to expect that the convergence of prices would materialise in the near or longer future without further action at EU level.

- **The need to upgrade the regulatory framework to tackle new market challenges**

For recent and new products the lack of harmonisation is a source of concern from the internal market perspective. On the market side, developments have accelerated within new e-cigarettes, heated tobacco products and a new generation of modern products is coming into the market (containing nicotine or cannabis). In particular, the current scope of the Directive is not capable of providing for an explicit harmonised taxation regime for e-cigarettes and heated tobacco products. As a result

Member states have established some taxation on these products but with different structures. The current lack of harmonisation of the tax regulatory framework for these products is also restricting the possibility to monitor their market development and control their movements.

- **The need for a holistic approach to enhance coherence**

The evaluation shows a low degree of coherence of the Directive with other EU policies and the need to develop synergies. There is a need to have a more comprehensive and holistic approach, taking on board all aspects of tobacco control including public health, taxation, the fight against illicit trade and environmental concerns. More coherence is also needed in view of the EU agenda in the fight against cancer.

ANNEX 1: PROCEDURAL INFORMATION

1. Lead DG, Decide Planning/CWP references

| Agenda Planning Reference AP N° | Title | Foreseen adoption |
|------------------------------------|---|-------------------|
| PLAN/2017/1028 | Evaluation of Council Directive 2011/64/EU | November 2019 |

2. Organisation and timing

The Inter-Service Steering Group (ISSG) was set up in 2018 and included the following DGs and Services: SG, SJ, AGRI, JRC, OLAF, SANTE, TAXUD.

Five meetings were organised between May 2018 and October 2019. The feedback on the external study received from these Directorate Generals and services has been taken into account.

Further consultations with the ISSG were carried out by e-mail. The ISSG approved the Evaluation and Fitness Check Roadmap. The ISSG also discussed the main milestones in the process, in particular the consultation strategy and main stakeholder consultation activities, the terms of reference for the external support study, key deliverables from the support study, and the draft evaluation report.

3. Evidence, sources and quality

The starting point for the drafting of the evaluation report was the report of a support study prepared for the Commission by Economisti Associati. Information provided by the stakeholders through the stakeholder consultation activities were another source of information (see Annex 2).

ANNEX 2: STAKEHOLDER CONSULTATION

Objective and scope

The overall objective of the consultation with stakeholders was to gather factual information, data, knowledge and perception about the current tobacco taxation in the EU, as well as on novel products (e-cigarettes and heated tobacco products) and appropriate options for a possible revision of Council Directive 2011/64/EU.

Consultation strategy and stakeholder identification

As a first step, it was necessary to identify stakeholder groups who might be concerned by the current Directive and possible future amendments of the Directive. The following stakeholders' categories were considered relevant for the evaluation:

- **Public authorities:** national governments have a major role on the functioning of the Directive in practice with the responsibility of the implementation and enforcement. Especially tax authorities (enforcement), ministries of finance (revenue) and ministries of health (health effects of excise duties on tobacco) have a high interest. Due to the fact that harmonisation of national legislation on indirect taxation has to be agreed by the Council according to the unanimity rule, national governments have also a large influence on the (re)design of the Directive.
- **Industry/business/associations:** This stakeholder group, active on the market of manufactured tobacco products covered by the Directive, has a high interest in the Directive. Operators releasing manufactured tobacco products for consumption are liable for the excise duties. They are affected by all subjects of the Directive, structure of rates, minimum rates, definitions, collection of excise duties, exemptions, derogations, refunds etc. For the same reasons, associations representing the interests of the industry will also have a high interest in the Directive. Amending the scope of the Directive might limit or extend the group of affected stakeholders. This group also includes operators involved in the industry value-chain, such as retailers, growers and processors.
- **NGOs:** NGOs active in the health area have an interest in the Directive because the Union's fiscal legislation on tobacco products needs to ensure, besides the proper functioning of the internal market, a high level of health protection. A certain degree of convergence between the tax levels applied in the Member States could be helpful to reduce fraud, smuggling and ensure a high level of protection of human health within the EU. Also, the level of taxation plays an important role in the price of tobacco products which influences consumers' smoking habits.

- **Citizens/General Public:** The general public is the largest stakeholder group. Even if not directly affected by the Directive, the structure and level of excise duties and the scope of the Directive indirectly affects the general public. The level of taxation plays an important role in the price of tobacco products.

Consultation tools

The Directive has already undergone in 2017 an open public consultation in the context of the previous Impact Assessment Study (EA 2018). The 2017 consultation covered primarily the possible introduction of new harmonised categories for new products and raw tobacco. It also covered other revisions of structures and categories of tobacco products other than cigarettes. The public consultation carried out in 2018 complemented the previous one, placing a greater focus on a possible revision of minimum rates and the taxation of cigarettes. It also covered the possible harmonisation of new products, in the light of the regulatory and market change occurred.

The following consultation activities have been carried out:

- **Open Public Consultation** : The consultation was open for 15 weeks and ran between the 23rd of May until the 3rd of September 2018
- **Targeted consultations:** In addition to the public consultation, stakeholders such as relevant authorities from each Member State were invited to complete a targeted questionnaire.
- **Interviews:** In-depth interviews with public authorities, industry representatives and public health stakeholders also took place, to collect additional information on the subject matter.

The table below provides more information by stakeholder type on the method of consultation, the consultation period, content and language.

| Stakeholder type | Method of consultation | Consultation period | Content | Language regime |
|---------------------------|---|-----------------------|--|-----------------|
| Public Authorities | Targeted questionnaires followed up by telephone and in-depth interviews as appropriate | July - September 2018 | Views on the current challenges and opportunities that the rates and structures of harmonised tobacco taxation offers and the possible harmonised taxation of e-cigarettes and novel tobacco | EN |

| | | | | |
|---------------------------------------|---|----------------------|----------|-------------------------------|
| | | | products | |
| Industry/business/associations | Targeted questionnaires followed up by telephone and in-depth interviews as appropriate | May-July 2018 | As above | EN |
| NGOs | Targeted questionnaires followed up by telephone and in-depth interviews as appropriate | May-July 2018 | As above | EN |
| Citizens/General Public | Open public consultation | May – September 2018 | As above | All EU languages except Irish |

In addition to the public consultation, all other stakeholder consultation activities were organised within the supporting evaluation study.

The consultation of e-cigarettes stakeholders has been conducted primarily in the form of a structured collection of data from direct concerned stakeholders (i.e. trade associations, economic operators, users associations), complemented by semi-structured interviews.

Results

➤ Open public consultation

The public consultation was intended to gather the views of any interested party – from economic operators, to non-government organisations (NGOs), to individual citizens etc. on two main issues:

- (1) The current taxation of conventional tobacco products (cigarettes, cigars and cigarillos, and smoking tobacco) and specifically the level of rates and structures;
- (2) The status of novel products, i.e. ‘electronic cigarettes’ and ‘heated tobacco products’, which are not explicitly covered by the Directive.

The consultation was carried out through an online questionnaire administered through the EU Survey platform. The survey was launched on the 23rd of May and closed on the 3rd of September 2018.⁷⁰

The questionnaire consisted of 26 questions, including both general questions and more technical ones.

Overall, the public consultation received 11,388 valid responses⁷¹, of which the vast majority (96%) from citizens responding on an individual capacity and some 4% from representatives of industry, NGOs, public administrations, academic institutions and other corporate entities. The high rate of response among individual citizens is primarily due to the massive participation of e-cigarettes consumers.

Some of the respondents have also chosen to upload a position paper to further explain their views. A total of 200 position papers have been received.

The analysis of the results of the public consultation as well as all contributions received, are available on the Commission's website⁷².

The stakeholders' opinions on the issues raised in the public consultation generally diverge in accordance with the specific interests of the respondent. Public health stakeholders invariably support stricter tax measures on tobacco, while the tobacco industry and trade stakeholders advocate for minimal or no revision of the current situation. If any, a revision of the fixed amount minima seems comparatively more supported than a revision of the minimum incidence of excise duty on price. Whether higher tax rates would lead to a reduction of smoking prevalence or to an increase of illegal products are very divisive issues. Conversely, there is a moderate agreement that some substitution of cigarettes with other tobacco products, or novel products, as well as an increase of cross-border shopping are likely consequences.

With respect to novel products, the widespread concern among e-cigarettes stakeholders and consumers about the possible adverse effects of e-cigarettes taxation should be noted, although a significant share of operators would seemingly support a harmonised definition with no minimum rate attached to it. More consensus can be found on the need to harmonise heated tobacco products – a need that is supported by the industry itself to overcome the current legal fragmentation.

⁷⁰ A longer period was foreseen to take into account the summer period

⁷¹ The total replies received amounted to 11,410 but 22 records appeared as duplicate submissions from the same entity so were excluded from the analysis.

⁷² [Results of the Public Consultation](#) on excise duties applied to manufactured tobacco and the possible taxation of novel products

- **Targeted consultation of Member States authorities**, further subdivided into two separate questionnaires addressing respectively:
 - Tax and customs authorities. Total respondents: 24 Member States.
 - Public health authorities. Total respondents: 15 Member States.

- **In-depth interviews with selected stakeholders**, including tax, customs and public health authorities, economic operators and trade organisations representing both the conventional tobacco products and novel products such as e-cigarettes and heated tobacco products. Total interviewees: 52 from 43 different entities.

- **Email consultation of e-cigarettes stakeholders**, to complement and expand the above interview programme, and including trade organisations, consumers associations, businesses and consumers. Total respondents: 52 from 10 countries.

Perceived coherence and relevance

The results of the consultation activities carried out through the external study indicate that all in all the objectives and measures laid down in the Directive are coherent and aligned with other EU policies and international obligations. This judgment is confirmed by the majority of key stakeholders consulted. In particular, with few exceptions (notably cigarillos) the excise definitions of products are consistent with customs classification, while no major competition issue was ever raised against the Directive (some legal interpretations were occasionally required).

The Directive has taken up the Framework Convention for Tobacco Control (FCTC) guidelines' recommendations on effective tax policies and the objectives of the EU and FCTC policies against illicit trades although according to public health stakeholders the Directive's provisions seem not fully geared towards the achievement of major results in these areas.

When compared to national priorities the objectives of the Directive are generally but not always aligned. By far the most important aim of national tax policies is to maintain stable and predictable tax revenue, but such aim is not explicitly considered or acknowledged in the EU excise legislation.

Conversely, there is a close alignment between MS and EU priorities as concerns ensuring and effective monitoring and control of tax compliance. To ensure fair competition and harmonised classification rules are both national and Directive's objectives, while reducing the tax differential between Member States (hence cross-border shopping) is a major EU objective that rank fairly low among Member States priorities.

Tobacco control objectives are also not a main priority for tax authorities although they are evidently so for public health authorities. Regarding the relevance of the Directive for

tobacco control stakeholders acknowledge the contribution of measures like EU minima or the approximation in the taxation of cigarettes and fine-cut tobacco, whereas little can be said, according to public health experts, on the ‘convergence’ of tax levels between EU countries since it is an area poorly investigated.

Another area frequently voiced as not sufficiently in line with the needs of the public health community is the lack of any explicit quantifiable public health objective in the Directive, particularly in the light of the fact that these are now available within the structure of the Framework Convention on Tobacco Control as a whole and could therefore serve as reference benchmarks.

Perceived impact of the Directive

A vast majority of respondents to the targeted consultation of fiscal authorities have acknowledged the Directive had some impact on informing their tax policies and setting their duty levels. Such impacts regard primarily raising national tax levels on manufactured cigarettes and fine-cut tobacco, both directly (i.e. to comply with requirements) or indirectly to keep-up with neighbouring EU countries and general trends. For the other tobacco products, a more indirect role of the Directive in shaping prices and influencing the market is reported, although in a few cases the impact was a major one (i.e. the phasing-out of special definitions of cigars and cigarillos for a couple of countries).

Most of the added value generally recognised to the Directive is first of all of a technical nature. The Directive represents the indispensable legal framework for the coherent classification of tobacco products across Europe and for the establishment of a harmonised tax collection mechanism compatible with the single market. This is acknowledged by the majority of tax authorities.

In line with the results of the analysis, there is far more scepticism that the Directive might have represented a viable mechanism to promote the convergence of tax levels across Member States or in specific macro-regions of the EU. This limited effect can be seen in both the markets for cigarettes and fine-cut tobacco, with significant convergence reported by just a couple of EU countries. On the other hand, it is acknowledged that the Directive have prompted the harmonisation of excise duty structure for cigarettes but this had limited concrete effects on the overall tax and price convergence between countries.

As a result of this limited harmonisation, a somewhat modest direct impact of the Directive in decreasing cross-border shopping is reported. The added value of the Directive is therefore mainly perceived as a stabilisation mechanism to avoid price competition between EU countries and prevent major market disruptions in trade flows. Interestingly, the majority of fiscal authorities still see some benefits in the fact that the Directive works to discourage ‘competitive taxation’ of tobacco products. However, this

mechanism is not considered having relevant effects in ensuring fairer competition between large and small players.

This widespread perception that the Directive has overall succeeded in avoiding fiscal competition between countries but could do relatively little to achieve a real convergence can be found also among respondents to the targeted consultation of public health authorities. These authorities generally recognised that the reduction in smoking prevalence would have probably been lower without the contribution of the Directive, particularly as far as impact on the young is concerned. Only one respondent dissented with this opinion assuming that the Directive *de facto* pre-empted the adoption of much bolder policy stances from public health perspective.

On the other hand, according to public health stakeholders the smoking prevalence has not decreased as it should have been in the period considered, and most of them attribute this failure, at least in part, to insufficient taxation. In this sense, various interviewees saw some link between the ‘conservative’ minimum rates envisaged in the Directive and the fact that taxation has not increased enough in a number of EU countries (including those that were already compliant with EU minima).

Perceived Efficiency of the Directive

By its own nature the Directive does not pose major problems with implementation or cause major administrative burdens on public authorities. Coherently, there is a general consensus among the respondents to the targeted consultation of the fiscal authorities that the administrative burden imposed on them by the tobacco excise legislation can be considered as acceptable and fully justified by the benefits it produces. Since no major changes were introduced in 2011, practically all respondents agree in considering that this administrative burden has remained fairly stable over time.

The appearance of ‘bulk’ tobacco as an illegal way of circumventing excises for fine-cut tobacco has highlighted the definition of ‘smoking tobacco’ as potentially inefficient and deserving possible refinements. This was compounded with the impact of stricter definitions reportedly adopted in some EU states following the EU Court of Justice’s ruling C-638/15 in 2017. Issues with the classification of tobacco refuses are mentioned by only a minority of relatively large Member States where large tobacco factories are located, but hardly an issue for the others.

Past experience of problems with the definition of cigars and cigarillos and its misalignment with the customs CN definition is still reported as a major problem by a handful of Member States but already perceived as much less severe or as no problem at all by all the others. The case of heated tobacco seems quite different, and there is overwhelming consensus that a harmonised approach to the taxation of heated tobacco should indeed be established at the EU-level to avoid legal fragmentation and the underlying administrative costs of reconciling shipments made under different tax

systems, even if this came at the cost of overhauling the existing IT systems of all EU countries by introducing a new category.

Finally, a majority of respondents seems inclined not to consider water pipe tobacco as an issue serious enough to justify the establishment of a separate tax category and therefore they do not also appear ready to bear the related adaptation costs. Only two Member States consider it worth the effort the establishment of a dedicated tax category for water pipe tobacco, with all the ensuing operational costs.

Business-respondents to the open public consultation were given the possibility to indicate more specific regulatory burdens imposed on their economic activities by the EU excise legislation. In practice, none of respondents indicate any burden of such kind, largely confirming the limited effects of the Directive in this respect. The few answers received, have come from e-cigarette operators lamenting the effects of national tax regimes in their country of origin, but this remains outside of the scope of the Directive.

ANNEX 3: METHODS AND ANALYTICAL MODELS

Approach and method

An external study has been contracted in order to support the evaluation of the tobacco tax Directive. The research was designed and conducted in a participative and collaborative way with the European Commission and all relevant stakeholders, whose input was important to inform the analysis.

The study – *Study on Council Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco, Economisti Associati, 2019* – was organised under the Framework Contract TAXUD/201/CC. It was commissioned to support the evaluation of the Directive framework. The study was organised as an evaluation, following the requirements of the Better Regulation Guidelines, and the evaluation questions were presented in the main document of the evaluation.

The study provided as well the reconstructed intervention logic for the Directive. The intervention logic was reconstructed from the recitals of the Directive and the analysis of any accompanying documentation at the time of the preparation and negotiations of the Directive. The Inter-service Steering Group, which accompanied the study, discussed and validated the intervention logic.

Scoping

The study covered in principle all 28 EU Member States, at least for the general appreciation of the Directive's functioning. They thus consisted of both a general EU-wide analysis of the implementation of the Directive for all Member States. The time period the evaluation covers years 2010 – 2017.

Data collection

The study was structured as an evaluation and followed a mixed-methods approach, featuring a range of tailored and targeted techniques and tools. They have been designed and deployed in a way that was deemed to bring the most value to the analysis. The analysis was based on numerous consultations with stakeholders (as presented in Annex 2), as well as desk research accompanied by in depth analysis of economic and statistical data using and cross checking different existing databases and an econometric analysis.

Desk research

An extensive mapping and review of documentary sources was conducted. The first line of research focussed on Directive 2011/64/EU and the broad policy environment: the public health policy framework, the policy framework concerning the fight against illicit trade of tobacco and fraud, the excise duty system legal and operational framework; the jurisprudence of the CJEU; the related customs framework the competition cases.

A second line of desk work involved collecting and mapping the existing scientific literature on four main themes, as follows:

- Thematic EU-funded studies concerning specific issues at stake and research projects on tobacco control policies. Other relevant studies and reports published by international organisations, i.e. WHO, the World Bank, OECD etc.
- Existing publications on modelling and analysing cigarettes and tobacco market dynamics, i.e. correlation of tax levels, prices and consumption, substitution across products, substitution with illicit products etc., including those promoted by national tax authorities.
- Existing publications on trends and factors underlying demand for tobacco products and smoking prevalence, including the relative impact of taxation and other tobacco control measures on demand, and socio-demographic factors, as well as literature on the quantification of ultimate public health impact of tobacco consumption.
- Specific information on new products regulatory and market trends in EU countries, as well as information on product developments, including outside the EU.

Databases

The study findings largely rely on extensive panel data concerning the key variables of the logic model described above. To this end, an inventory of available data was carried out during the inception phase. This was followed by a substantial effort of systematisation of datasets, to address the numerous consistency and completeness issues that emerged. This effort was necessary both for providing a thorough answer to the descriptive questions on the overtime trends in the market and taxation of tobacco, and for feeding these data in the quantitative analysis models. In fact, as discussed further below, some of the datasets identified turned out too incomplete or inconsistent to support an econometric assessment and different approaches had to be devised.

The main datasets collected and processed were:

- The Excise Duty Table (EDT) series compiled by DG TAXUD and the related Tax in Europe Database (TEDB):
 - i. Tax rates and structures applicable in the Member States to the various categories of tobacco products and related main indicators, i.e.: the weighted average price (WAP), the excise duty yield at WAP level (EDY) and the total tax burden (excise duty plus VAT).
 - ii. Tax receipts, broken down by cigarettes, cigars, cigarillos and other smoking tobacco.
 - iii. Releases for consumption (RfC) data for cigarettes and fine-cut tobacco. In some cases, it was necessary to disaggregate FCT from other smoking tobacco, which

some Member States report jointly, and to fill data gap through estimates based on adjusted Euromonitor International data.⁷³

- Euromonitor International data series since 2005 for all Member States
 - iv. Overall market volume and value (in national currency and EUR) – primarily used for filling gaps in the RfC series and as the base for calculation of other analytical indicators based on the sample of brands covered by Euromonitor.
 - v. Retail price of cigarettes and FCT. Euromonitor International collects this information from store checks often providing separate figures for: (i) different stock-keeping unit (i.e. the different types of the same brand); (ii) different packaging (box or paper, number of units contained); (iii) different outlets (tobacconist, supermarkets, bar and restaurants, petrol stations etc.). In seven EU countries the price of stock-keeping units can change at the retail level, so the consultant had to calculate a single average price per brand. Some data gaps regarding recent years were filled through direct price search on retail outlets of the Member States. For the analysis of price trend in one country, the consultant used prices expressed in national currency, to avoid the distortion induced by fluctuation in the exchange rate.
 - vi. Market share by brands of cigarettes and FCT. The raw datasets contained some gaps and other scarcely plausible figures that had to be corrected through modelling. However, in order to avoid distorting the results of the analysis a ‘light touch’ was adopted. The consultant primarily used these figures for the segmentation of the cigarettes market between low, mid, and premium price categories and for simulating the impact of change of structures on the market equilibrium.
- EcigIntelligence database and its market and regulatory ‘trackers’ on e-cigarettes and heated tobacco products (HTP). In particular, the figures drawn from EcigIntelligence regard: (i) market value and trends in Member States (some 18 countries covered), (ii) price level trends for the various type of product, (iii) the estimated prevalence of consumers of e-cigarettes in the population, and (iv) the tax regime applied (where relevant). The EcigIntelligence data are collected through a number of sources and are the most detailed and consistent market source available, but they are not officially validated data. At present, there are no official statistics on these products available at the EU level. As regards the consumption prevalence, the consultant developed model estimates combining EcigIntelligence data with the results of the Eurobarometer surveys , and Euromonitor International estimates on

⁷³ For instance, since 2017 figures are not provided in the EDT, the consultant has applied to EDT 2016 figures the growth rate registered by Euromonitor in 2017. The Euromonitor figures could not be taken ‘at face value’ since they are estimated differently, however in terms of trend they seem largely consistent with EDT data.

the share of users among the population. Regarding heated tobacco products, the information available at the time of the study consisted of essentially one product market data that have been retrieved primarily from the manufacturer's (PMI) periodical report to investors.

- For smoking prevalence, the consultant has matched different sources and in particular: WHO, Eurostat-EHIS, Eurobarometer, and national estimates indicated by the public health authorities who took part in the consultation. The affordability indicators were developed combining different sources.
- There are limited data sources on illicit trade of tobacco flows and magnitude. At the time of research, the most comprehensive panel data source available was the KPMG's Project SUN (hereinafter 'SUN') report series, which contain detailed estimates of the overall amount of non-domestic consumption of cigarettes for all Member States, further broken down by legal and illegal consumption (contraband and counterfeit, including 'illicit whites') and the origin of flows.⁷⁴ The SUN estimates are based on the 'empty pack survey' data collected at Member States level by different independent market research agencies and elaborated by KPMG through its 'flow model'.⁷⁵ Although formally an independent exercise, commissioned in the latest edition by the Royal United Services Institute for Defence and Security Studies (RUSI), the Project SUN is sponsored by the industry.⁷⁶ For this reason the validity of its results have been questioned⁷⁷ and need to be taken with due caution.

The consultant managed to develop its own estimates for analytical purposes - and considering the above caveats – using the raw data underlying Project SUN. The raw data were re-elaborated by the consultant in line with the study needs and duly highlighting the (in)consistency with own survey-based estimates (elaborated from Eurobarometer) and seizures data collected from OLAF and directly from Member States (through the tax authorities' consultation). As clearly specified by data providers, seizures data present serious limitations of comprehensiveness (estimated underreporting especially for minor-size seizures) and comparability (the databases are not checked and cleaned), so they should be taken with great caution.

- All other macro-economic and socio-demographic data required were sourced from Eurostat databases. In addition to the already-mentioned statistics on production and

⁷⁴ See: <https://home.kpmg.com/uk/en/home/insights/2018/07/project-sun-2017.html>. In early years, the project was named Project STAR. Overtime there has been refinements in the data collection and the analytical methodology applied, but no major break of time series is apparent.

⁷⁵ For a detailed description of the methodology used in Project SUN see KPMG, 2017 Results, Methodology and Appendices

⁷⁶ Initially (Project STAR) the exercise was sponsored by PMI then, until 2015, by the four Big Tobacco companies. In 2016, JTI did not support the exercise.

⁷⁷ See: Joossens et al., From Cigarette Smuggling to Illicit Tobacco Trade, 2012; Gilmore et al., 'Towards a Greater Understanding of the Illicit Tobacco Trade in Europe: A Review of the PMI Funded 'Project Star' Report', 2013.

trade, the consultant has collected from Eurostat data on GDP and income trends (inter alia to calculate the ‘affordability’ variable), price level and inflation trends (harmonised indexes of consumers prices – HICP), purchasing power parities (PPP) of EU countries, input/output tables, household budget expenditure, population trends etc. Exchange rates have been drawn from the European Central Bank annual averages.⁷⁸

Econometric analysis

The backbone of the study consists of a broad-scope quantitative analysis carried out through econometric methods, which aimed at investigating the dynamics of the tobacco market in the EU countries in relation to the tax policies established at the EU level.

⁷⁸ The EDT normally use the exchange rate registered in October of the previous year, which may be slightly dissimilar from the average annual exchange rate used in the external study (for countries whose exchange rate with the Euro is not fixed).

ANNEX 4: TAX STRUCTURES AND MINIMUM RATES

Cigarettes

The tobacco tax Directive (Articles 7 to 12) requires Member States to levy a minimum rate of excise duties on cigarettes.

This minimum rate must consist of:

- A **specific component** of between 7.5% and 76.5% of the total tax burden (TTB) - expressed as a fixed amount per 1000 cigarettes
- An **ad valorem component** - expressed as a percentage of the maximum retail selling price

In addition, the overall excise rate must be:

- At least EUR 90 per 1000 cigarettes
- At least 60% of the weighted average retail selling price

Member States that apply excise duty of EUR 115 or more, however, do not need to comply with the 60% criterion above.

EU legislation only sets harmonised *minimum* rates. Member States are free to apply excise duty rates above these minima, according to their own national needs.

Specific provisions exist to allow Portugal to apply a reduced rate up to 50% less than the required overall minimum excise duty on cigarettes consumed in the most remote regions of the Azores and Madeira.

Other tobacco products

The Directive also sets down minimum excise duty rates for manufactured tobacco other than cigarettes (Articles 13-14).

The structure for taxing "other tobacco products" is slightly different than for cigarettes.

Member States can choose between applying a specific component or an ad valorem component, or if they wish, they may apply a mixture of the two.

Minimum rates are set out for three distinct categories of "other tobacco products"

| Product Category | Minimum Rate |
|--------------------------|---|
| Fine-cut smoking tobacco | 48% of the weighted average retail selling price* Or EUR 60 per kilogram* |

| | |
|------------------------|---|
| Cigars and Cigarillos | 5% of the retail selling price Or EUR 12 per 1000 or per kilogram |
| Other smoking tobaccos | 20% of the retail selling price Or EUR 22 per kilogram |

* To gradually increase, by 2020, to 50% or EUR 60

Minimum Excise Duty

The Minimum Excise Duty (MED) represents the minimum amount of excise duty (per quantity of product) that a Member State can decide to levy on certain tobacco products when the sum of specific and ad-valorem duties falls below an established threshold that is defined nationally. The MED consists in a tax 'floor' and was designed to prevent the risk of too low taxation (hence too low prices) and 'race to bottom' in the cheaper segments of the market.

ANNEX 5: MAIN CJEU RULINGS ON THE INTERPRETATION AND IMPLEMENTATION OF THE DIRECTIVE⁷⁹

| Subject | CJEU Rulings |
|---|---|
| Dismissal of minimum retail price provisions for in certain Member States | <p>C-197/08 Commission v France</p> <p>C-198/08 Commission v Austria</p> <p>C-221/08 Commission v Ireland</p> <p>C-571/08 Commission v. Italy</p> |
| Dismissal of MED higher than the excise applicable above MPPC level | C-428/13 Yesmoke Tobacco |
| Dismissal of quantitative restrictions on products moved cross-border for own consumption | C-216/11 Commission v France |
| Admissibility of national legislation prohibiting price rebate at retail level | C-221/15 Etablissements Fr. Colruyt |
| Interpretation of the excise definition of 'smoking tobacco' | C-638/15 Eko-Tabak |
| Action against strict anti-forestalling measure | C-126/15 Commission v. Portugal |
| Interpretation of the excise definition of cigarillos | C-638/17 Skonis ir kvapas |

⁷⁹ Source: Study on Council Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco, Economisti Associati, 2019

ANNEX 6: MAIN FINDINGS FROM PREVIOUS EVALUATIONS OF DIRECTIVE 2011/64/EU

Directive 2011/64/EU has already undergone an evaluation process, which started in 2012 under the Regulatory Fitness and Performance Programme (REFIT). Within this context, an independent evaluation study was completed in 2014 by a consortium led by Ramboll Management Consulting (hereinafter ‘Ramboll 2014’). On this basis, at the end of 2015 the Commission submitted a Report to the Council in 2015⁸⁰ and received in March 2016 the mandate to explore possible regulatory revisions.⁸¹ Within this framework, an impact assessment study was conducted by Economisti Associati in 2016-2017, which was published in January 2018 (hereinafter ‘EA 2018’)⁸² along with the Commission Report COM(2018) 17 final. In that report, the Commission explained the reasons why on certain issues a revision of the Directive was not required or premature at that moment in time.⁸³

The Ramboll 2014 focused primarily on efficiency and effectiveness aspects of the excise duty structures laid down in the Directive, and identified a series of possible issues that were further examined under the EA 2018, with a view to establish whether an amendment of the Directive was required. The minimum rates were not at stake in both exercises since they were too recently introduced.

In its Report 2018 the Commission noted among other things:

- There is a general lack of data on e-cigarettes and heated tobacco products to underpin a proposal for harmonised taxation. However, the Commission expressed the intention to re-consider the matter in the context of the current new evaluation process, taking advantage of new information possibly stemming from the Tobacco Products Directive reporting obligations under Article 20.⁸⁴
- Some issues identified in the Ramboll 2014 have since been solved at national level or have been settled, so an intervention is no longer need.
- The new evaluation of the Directive (in accordance with Article 19) shall include (primarily) a review of the minimum rates level established in the Directive itself.

⁸⁰ 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.

⁸¹ “Council conclusions on the structure and rates of excise duty applied to manufactured tobacco”, 08.03.2016

⁸³ COM(2018) 17 final, Report from the Commission to the Council on Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco.

⁸⁴ Directive 2014/40/EU of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC