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EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT

Accompanying the document

Proposal for a COUNCIL DIRECTIVE
on the structure and rates of excise duty applied to tobacco and tobacco related products
(recast)

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Executive Summary Sheet
Impact assessment for a proposal for a Council Directive on the structure and rates of excise duty applied to tobacco and tobacco related products
A. Need for action
What is the problem and why is it a problem at EU level?
<p>The initiative for a revision of the Council Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco is part of Europe's Beating Cancer Plan.</p> <p>The problem addressed by the impact assessment is the fact that the current Directive no longer fully achieves its twin objectives, that of ensuring both the proper functioning of the internal market and a high level of health protection. The current minimum tax rates have lost traction in terms of making an effective contribution to reducing tobacco consumption. Existing differentials incentivise irregular cross-border flows. The current scope of the Directive is not adapted to market developments, it does not cover new products such as liquids for electronic cigarettes and the application of excise duty to heated tobacco products is not explicitly established. Furthermore, illicit trade in tobacco products remains substantial and continues to constitute a source of concern in Member States.</p> <p>The main drivers of the problem are: i) relative price accessibility of tobacco products; ii) unfit EU minima; iii) divergent approaches to taxation between both products and Member States; and iv) ineffective control of the entire tobacco supply chain by Member States.</p>
What should be achieved?
<p>The revision of the current provisions of the Directive aims to:</p> <ul style="list-style-type: none"> ▪ update EU minima to ensure the proper functioning of the internal market and at the same time a high level of health protection in line with the objective of Europe's Beating Cancer Plan; ▪ ensure coherent fiscal treatment of new products in the EU (in particular liquids for electronic cigarettes and heated tobacco products, as well as new modern oral products); ▪ bring raw tobacco within the excise movement and control system (EMCS) to tackle the increase of illicit manufacturing of cigarettes inside the EU. <p>The main objectives of the proposed policy options are to:</p> <ul style="list-style-type: none"> ▪ ensure the proper functioning of the internal market; ▪ ensure a high level of health protection; ▪ fight against fraud and safeguard Member States revenues. <p>More specifically, this initiative intends to:</p> <ul style="list-style-type: none"> ▪ approximate Member States tax rates and regimes over the medium term¹; ▪ discourage tax induced substitution between different tobacco products and their substitutes within the short term; ▪ increase relative price levels to influence consumption behaviours with a view to reducing smoking prevalence along Europe's Cancer Beating Plan objective for 2040;

¹ In this paragraph, the short term refers to the period following implementation of the revised Directive until the preparation of the first evaluation (i.e. within five years of the application date of the new legislation), while medium-term effects shall be measurable up to 15 years after the implementation of the revised Directive.

- ensure legal certainty in terms of product definition and fiscal classification for all stakeholders within the short term;
- ensure effective excise administration, including effective enforcement, tax collection, fraud and avoidance mitigation, within the short term by expanding application of movement and control provisions.

What is the value added of action at the EU level (subsidiarity)?

The problems identified, in particular the incoherent fiscal treatment between and across products and the increasing illicit manufacturing of tobacco products within EU, and their drivers cannot be addressed by Member States in isolation. The limitations of the current regulatory framework negatively affect the effectiveness of national tobacco control and public health policies, which undermines the objectives of Europe's Beating Cancer Plan. A revision of the Directive is therefore necessary. No alternative national, bilateral or other international initiative would provide the same level of effectiveness in terms of addressing this issue for all stakeholders at EU level.

B. Solutions

What are the various options to achieve the objectives? Is there a preferred option or not? If not, why?

The policy areas examined in the impact analysis are (1) revising the EU minima and certain categories traditional tobacco products; (2) enlarging the scope of the Directive to new products; and (3) enlarging the scope to raw tobacco.

The options for *revising the EU minima and certain categories of tobacco products* follow the Council Conclusions, which noted that they should take into account the different economic situations of Member States. The three options propose a limited (Option 1), moderate (Option 2), and high (Option 3) increase of the EU minima, partially expressed in purchasing power parities (PPP) so as to better adjust for the economic reality of each Member State. At the same time, to ensure the durability of the policy stance over time, the minimum rates of excise duty should take into account the EU average inflation trends, based on the Harmonised Index of Consumer Prices (HICP). Options 2 and 3 include gradual increases for cigars, cigarillos and other smoking tobacco, designed to progressively bridge the gap with the rate for cigarettes over the medium term, contributing to the goal of Europe's Beating Cancer Plan.

The options for *enlarging of the scope of the Directive to new products* seek to create a level playing field and support the proper functioning of the internal market. For heated tobacco products, Option 1 proposes a moderate EU minimum rate; Option 2, a higher EU minimum. For liquids for electronic cigarettes, Option 1 proposes a zero rate for the EU minimum; Option 2, a positive rate; and Option 3, differing rates depending on nicotine concentration. For other manufactured tobacco and related products (including, new commercial nicotine products targeting young people), Option 1 proposes basic minimum rates; Option 2, limited minimum rates; and Option 3, high and gradually increasing rates.

The options for *enlarging the scope to raw tobacco* bring raw tobacco within the excise movement and control system (EMCS) in order to fight against the surge of clandestine factories in the EU. Option 1 proposes a zero rate for the EU minimum; Option 2, a positive rate aligned with the minimum rate levied on 'other smoking tobacco' products.

The preferred option combines an ambitious approach to minimum excise duty rates for traditional tobacco and new products, in order to effectively achieve the objectives set for the revision, consistently with broader policy objectives, while balancing out the incurred costs and administrative burden.

What are different stakeholders' views? Who supports which option?

The public consultation confirmed the importance of tackling the increasing substitution of cigarettes with other tobacco products (mainly with fine-cut tobacco for the rolling cigarettes) and even more so, with new unregulated ones (such as liquids for electronic cigarettes and heated tobacco). Despite citizens and industry respondents resisting the idea of increased taxation for a number of products, a majority of respondents agreed on the need to reduce the gap in tax levels between traditional tobacco products. However, they were not supportive of the full equalisation of rates among different products. Academics, NGOs, public health experts and other respondent categories almost universally agreed that taxation had to be increased and existing gap levels, closed.

Regarding new products, there was a broad consensus on the need to consider and harmonise the taxation of new products with the notable exception of replies from citizens regarding e-cigarettes (however, respondents were mainly e-cigarettes consumers). A majority of the respondents considered that electronic cigarettes should be taxed at a lower rate than traditional tobacco products.

Respondents acknowledged the importance of fighting against illicit trade and manufacturing of tobacco products and called for increased EU action. The majority (with the notable exception of industry representatives) were in favour of including raw tobacco among the goods to be monitored through the excise movement and control system (EMCS).

As the impact assessment was not followed by a legislative proposal at that time, a study was commissioned in 2024 to provide for an update of market and regulatory developments and related analysis. The study confirms that the options envisaged remain the most relevant and their estimated impacts remain accurate. The impact assessment has been updated to the extent necessary to incorporate such recent analysis and to reflect in the proposed EU harmonised minimum rates the inflation that occurred since 2022. It has also been complemented with the competitiveness check and SME check - both available in the respective annexes of the impact assessment, according to new Better Regulation requirements.

C. Impacts of the preferred option

What are the benefits of the preferred option (if any, otherwise of main ones)?

The preferred option for *revising the EU minima and certain categories of tobacco products* is option 3 – a high increase of the minimum rates with a transitional period of 4 years for cigars, cigarillos, waterpipe tobacco and other smoking tobacco. This option is the most effective in curbing tobacco consumption. It would reduce smoking prevalence to 20.8%, in line with the long-term goal of Europe's Beating Cancer Plan of a tobacco-free generation (where less than 5% of the population uses tobacco by 2040). This option could also lead to a significant increase in excise duty in nearly half of the Member States, and for some, an unprecedented increase, notably for products with historically low tax levels like cigars and cigarillos, which makes it difficult to envisage all market effects (reduced sales, high compliance costs for economic operators). However, the partial PPP-based approach mitigates the most extreme effects, allowing for higher ambition.

The preferred option for *enlarging of the scope of the Directive* is to introduce new excise categories for each of the new product categories. In terms of the minimum rates, option 2 is preferred for heated tobacco products; for liquids for electronic cigarettes option 3 is preferred, combining two flat rates for low and high-nicotine content products; option 3 is preferred for other manufactured tobacco and related products with a gradual increase of the fixed minimum over 4 years to EUR 143. Establishing harmonised definitions, tax treatment, movement and control requirements for new products would close a regulatory

gap, remove substantial fragmentation caused by various different national regimes, and enhance the functioning of the market for these products. Regarding the proposed excise duty rates, the introduction of high EU minima would reduce the tax gap between new products and traditional tobacco products, hence tax induced substitution.

The preferred option for *enlarging the scope to raw tobacco* is option 1 - new excise category for raw tobacco with a zero minimum rate. This option envisages applying the EMCS system to cross-border movements. In this sense, Member States authorities would have access to a readily available IT tool that allows monitoring of supply-chain operations, and therefore assists in detecting irregularities and potential diversion routes. By introducing a zero rate, the mechanism remains proportionate with the objective of addressing tax evasion, fraud and avoids double taxation.

What are the costs of the preferred option (if any, otherwise of main ones)?

The preferred option for extending the scope to new products and raw tobacco would generate a moderate increase in administrative costs for economic operators, which can occasionally be more significant for SMEs (mainly in the electronic cigarettes sector) due to the need to implement movement and control requirements applying to excise goods. Big tobacco companies active in the segment of new products are already equipped to deal with these rules. The additional administrative costs for tax authorities would also be moderate as Member States that have introduced excise duties for new products and raw tobacco already apply similar rules and control measures as for conventional tobacco products.

What are the impacts on SMEs and competitiveness?

Harmonised excise treatment and application of movement and control requirements (EMCS) for new products would remove market barriers caused by the fragmentation of Member State rules and regimes, creating new opportunities for operators, including SMEs, to expand their activities to other markets. However, SMEs would be comparatively more affected as they are less capable to absorb the cost increase. On the other hand, the tobacco sector is largely dominated by big tobacco companies, so negative effects for SMEs are expected only in the e-cigarettes sector, and to a much lesser extent, in the raw tobacco sector, and in limited subsectors (e.g. cigars, pipe tobacco, smokeless tobacco).

Introduction of control requirements at EU level for raw tobacco would reduce the availability of illicit tobacco and tobacco products in the market, so that legal players would experience lower competitive pressure from the illegal value chain, and this could partly compensate the extra costs incurred. Overall, it is not expected that these costs would significantly affect the competitiveness of EU-grown tobacco.

Will there be significant impacts on national budgets and administrations?

EU minima increases for traditional tobacco products will result in an estimated increase in annual tax revenues of EUR 14 billion in tax revenue across EU Member States.

The introduction of excise duty rates for new products will increase revenue by an estimated EUR 900 to 1 700 million under the preferred option.

The establishment of a harmonised category for raw tobacco in EU excise legislation will result in an estimated reduction in foregone tax revenues of approximately EUR 1.3 billion per annum.

Will there be other significant impacts?

No

Proportionality?

The proposal is proportionate and necessary to achieve the objectives, as it addresses current limitations of the legal framework at EU level. The proposed increase of EU minima is conducive to meeting Europe's Beating Cancer Plan goals. At the same time, Member States remain free to adapt the actual excise duty rates, and to some extent the tax structure, according to their national preferences. Clearer definitions of product categories, and the extension of the scope of the Directive to new products and to raw tobacco will support effective enforcement by Member States, and the smooth functioning of the internal market.

D. Follow up

When will the policy be reviewed?

The Commission will prepare an evaluation at the earliest five years after the application date of the new legislation, allowing markets to adjust and the results and impacts to materialise. Given that the revision of the Directive is one of the policy proposals under Europe's Beating Cancer Plan, monitoring and evaluation could be carried out in line with the other elements of the package.