

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(76) 22 final.

Brussels, 4 February 1976

PROPOSAL FOR A COUNCIL DIRECTIVE

amending Directive N°.72/464/EEC, as amended by Directives N°s, 74/318/EEC of 25 June 1975, and 75/.../EEC of 18 December 1975 on taxes other than turnover taxes which affect the consumption of manufactured tobacco

(submitted to the Council BY the Commission)

COM(76) 22 final.

EXPLANATORY MEMORANDUM

I. Introduction

In accordance with the Council Directive of 19 December 1972⁽¹⁾, as amended by the Council Directives of 25 June 1974⁽²⁾ and 18 December, 1975⁽³⁾ the first stage of harmonization of the structures of the excise duty on manufactured tobacco covers at present a period of 48 months from 1 July 1973 to 30 June 1977. This first stage concerns the excise duty on cigarettes only. Apart from certain general provisions on the principles of harmonization, the Directives do not contain any specific provisions concerning other manufactured tobaccos.

Article 1 (3) and (4) of the above Directive provides that the Council, acting on a proposal from the Commission, must adopt a Directive at least one year before the expiry of the first stage, i.e., before 1 July 1976, laying down the special criteria applicable during the following stage or stages.

This proposal for a directive concerns the provisions applicable during the second stage of harmonization of the structure of the excise duties on cigarettes. It does not concern manufactured tobacco other than cigarettes.

II. Background

On 21 April 1970, the Council adopted a Resolution⁽⁴⁾ concerning taxes other than turnover taxes which affect the consumption of manufactured tobacco. At that time, two excise systems for the taxation of cigarettes

(1) OJ No. L 303, 31 December 1972

(2) OJ No. L 180, 3 July 1974

(3) OJ No.

(4) OJ No. C 50/1, 28 April 1970.

existed in the Community of the Six. In Germany, a specific excise was levied as a fixed amount per cigarette; in the five other Member States, the excise was levied as a percentage of the tax-inclusive retail price.

The Council Resolution of 21 April 1970 provided that both these systems should be combined in a harmonized system consisting in part of a proportional component and in part of a specific component. The Council Resolution did not fix the relationship between the two components, but provided that at the final stage of harmonization, beginning 1 January 1980, the relationship should be such that the range of retail prices would reflect fairly the difference in the manufacturers' delivery prices.

These provisions of the Resolution were embodied in the Council Directive of 19.12.1972⁽¹⁾. The Directive also established that a first stage of harmonization would run for two years from 1.7.1973. During this stage, and without prejudice to the ratio finally to be adopted, the specific component of the excise to be levied on cigarettes was fixed at not less than 5% and not more than 75% of the aggregate amount of the ad valorem and specific components.

The Council Directive was of course adopted prior to the enlargement of the Community. However, during discussions on the Directive, two of the new Member States, Ireland and the United Kingdom, pointed out that their excise system for taxing cigarettes, which was levied on the weight of the raw tobacco, differed from both of the systems applied in the original six Member States. They represented that the directive would radically alter their markets for cigarettes and that a period of derogation would be essential. Both these countries were therefore accorded a derogation from the Directive until the end of 1977. Thus seven of the nine Member States implemented the first stage of harmonization by 1 July 1973.

(1) OJ No. L 303, 31 December 1972.

Discussions held during 1973, with a view to a second movement towards alignment of these different tax systems, proved abortive. In addition, the Commission itself felt that the accentuation of the different market conditions resulting from the enlargement of the Community required further examination before concrete proposals for a second stage could be put forward. The Commission therefore proposed, in March 1974, a twelve-month prolongation of the first stage, to 30 June 1976, in order to provide more time for the search for a satisfactory solution. A prolongation had the additional advantage of permitting the effects of the first stage to be assessed before further proposals were put forward. The Council adopted the twelve-month prolongation in its Directive of 25 June 1974⁽¹⁾.

The Commission also submitted in March 1974 a draft second Directive on harmonization of tobacco excises⁽²⁾, which specifies the groups of products into which manufactured tobacco is to be divided within the harmonized system, and defines the characteristics of each product group. The Economic and Social Committee and the European Parliament gave their opinions on the proposals in July and November 1974 respectively⁽³⁾.

The Commission attaches some importance to the prompt adoption of this Directive, since it is manifest that progress in harmonizing other aspects of the tax structure should be matched by the adoption of uniform product groups and definitions. If this is not the case, inconsistencies in the coverage of the tobacco taxes may emerge as harmonization progresses. The Commission also notes that both the European Parliament and the Economic and Social Committee recently deplored the Council's failure to adopt the Second Directive⁽⁴⁾, and urged the Council to do so without delay.

(1) OJ No. L 180, 3 July 1974

(2) OJ No. C 72, 27 June 1974

(3) OJ No. C 125, 16 October 1974 (ECS) OJ No. 155, 9 December 1974 (EP)

(4) OJ (Resolutions on second prolongation).

OJ No. C. 239, 20 October 1975.

Late in 1974, the Commission authorised a study by consultants into the likely effects on demand for cigarettes of black and blond tobaccos sold on Community markets in response to changes in the system of taxing manufactured tobaccos. The study examined three alternative excise structures for cigarettes: a structure with a high specific component; a structure with a high ad valorem component; and a structure combining substantial ad valorem and specific components. The consultants received a high level of co-operation and much data from tobacco producers throughout the Community. They also discussed their estimates of the probable effects of each of the three alternatives with the major cigarette producers.

The report on the study concluded, inter alia, that over the Community as a whole, harmonization on a predominantly ad valorem structure seemed likely to produce less disturbance in the short term to existing market patterns than would either of the other two alternatives examined. However, it was also concluded that there are grounds for the view that a structure combining at the final stage substantial elements of both ad valorem and specific taxation would increase the possibility of increased inter-penetration of markets. The precise ratio of specific to ad valorem taxation which would create balanced opportunities for such inter-penetration would require further study. The report also referred to concern expressed by private sector producers at the pressure on profit margins and product quality of a predominantly ad valorem structure, and concluded that further study was necessary in order to evaluate such problems.

These conclusions are of course the responsibility of the authors of the study, and in no way commit the Commission. Nevertheless, the Commission considers that the study contributes usefully to discussion of tobacco excise harmonization, and has taken its findings into account in the preparation of the present proposals. The study will be published as soon as possible.

III. The general lines of the proposal

Broadly, the choice for future proposals appears to lie between the alternatives of continued prolongation of the first stage pending agreement on the final structure, slow progression via a large number of modest stages, or moving as soon as possible (i.e., from 1 July 1977) to a second stage requiring substantial increases in the minima for both the ad valorem and specific components. The first course has so far proved fruitless. The second would prolong the excise harmonization process far into the future. Such a process would expose producers in particular to continuing uncertainty both as to the final outcome and as to each succeeding stage, and would inevitably inhibit product and investment planning over a lengthy period. Moreover, successive small steps would provide only a gradual stimulus towards market interpenetration. The third course seems likely to provide an immediate stimulus to market interpenetration. By reducing substantially the spread between the permitted minimum and maximum percentages for both the specific and ad valorem components, it would appreciably narrow the gap to be bridged at the final stage, but would leave a margin for manoeuvre at the final stage, to be used in the light of experience during the second stage. By comparison with the second alternative, it would greatly reduce both the degree and the period of uncertainty for producers. The Commission proposals are therefore based on the third choice above.

IV. The absence of proposals for the final stage

The European Parliament, in its opinion on the proposal for a second prolongation of the first stage, urged the Commission to submit proposals for a second and subsequent stages as soon as possible. The Commission understands, and indeed shares, the concern to reduce uncertainty over future harmonization to a minimum. This is clearly desirable. Reference has already been made to the inhibiting effects on long-term planning of continuing uncertainty over the future path of excise harmonisation. The question of whether or not the present proposal should, in addition to the second stage provisions, include provisions for the final stage, has therefore been carefully considered.

Unfortunately, discussions to date have merely demonstrated the persistent divergence of viewpoints on the relationship to apply at the final stage between the specific and ad valorem elements in a harmonized excise. Little or no change has been remarked in the differing viewpoints during discussions over the last two years. The likelihood of agreement on a proposal for the final stage is therefore slim at the present time. Moreover, to submit such a proposal now would run counter to the concept of progressive harmonization. If such a proposal were adopted, it would commit the Community to the final stage in advance of the experience of the second stage. In other words, if harmonization is to progress with some flexibility and in the light of experience, some degree of uncertainty is an unavoidable consequence. Finally, the report of the study to which reference has already been made, suggests that the final stage requires further study on a variety of counts before proposals are formulated.

For these reasons, the Commission has concluded that its present proposal should be confined to the second stage. However, as has already been pointed out, the proposal is intended to reduce both the period and degree of uncertainty by as great a margin as is practicable.

V. The length of the second stage

It is proposed that the second stage should run from 1 July 1977 to 31 December 1980 - a period of $3\frac{1}{2}$ years. A third and final stage would therefore commence on 1 January 1981. This date is 12 months later than the deadline of 1 January 1980 originally fixed by the Council in its resolution of 21 April 1970. However, the successive prolongations of the first stage have made it extremely difficult to meet that deadline whilst at the same time permitting a relatively smooth transition from the existing situation. A second stage of significantly less than $3\frac{1}{2}$ years duration would oblige the Commission to begin preparation of proposals for the final stage before the full effect of the second stage proposals had been felt in all Member States, since Ireland and UK, by virtue of their derogation until 31 December 1977, are unlikely to begin the harmonization process until six months after the proposed

commencement date for the second stage. As both these countries at present apply an excise which is neither proportional by value nor specific by unit and have not even undergone the effects of the first stage of harmonization, it is of particular importance that harmonization in these two countries should be given time to have its full effect before measures for the final stage are prepared. In view of these considerations, the Commission feels that a second stage of the period proposed is essential.

VI. Inclusion of VAT in the ad valorem component

In the first directive of 1972 it was provided that the specific component in the excise duty should be determined by reference to the sum of the two components of the excise duty (specific component plus proportional component). It is now proposed, for the second and subsequent stages, that the specific component should be calculated by reference to the total tax levied on consumption of cigarettes (specific component plus proportional component plus proportional VAT).

In a mixed excise duty system such as that established for cigarettes, VAT, which is a proportional tax by definition, modifies all the relationships, since the proportional component of the excise duty is calculated on the basis of a retail selling price, inclusive of all taxes (i.e., the specific and proportional excise component and also VAT). The incidence of VAT on retail selling price, although of course much less than that of the excise, nevertheless varies appreciably from one country to another. A table of VAT rates is attached at Annex 1. Thus, it appears essential that the size of the specific component of the mixed excise duty should be fixed, not in relation to the total excise duty, but in relation to the total tax levied on consumption (excise duty + VAT).

VII. The proposed specific/ad valorem relationship during the second stage

The Commission has been informed by the Member States that the provisions relating to the first stage (specific component equal to between 5% and 75% of the total excise duty) have not appreciably affected either the tax revenues or the market conditions in the seven Member States in which these provisions are currently applied. In fact, this range broadly reflects the situation which obtained in the original six Member States: five Member States each undertook an alignment of 5% (0 to 5%), whilst one undertook an alignment of 25% (100% to 75%); as a result of its accession to the Community, Denmark brought the specific excise component to 75% (the United Kingdom and Ireland having obtained deferment until 31 December 1977).

The extent to which the permitted variation in the specific component should be compressed during the second stage depends upon a variety of considerations. First, the Commission envisage a relatively long second stage which will in practice be the last stage before the final harmonization of structures. Secondly, the reduction in the permitted variation in the specific component (and consequently, the increase in the required minimum percentage for both the specific and ad valorem components) should be sufficiently great to offer a marked stimulus to market interpenetration, since the prospect of increased export markets in return for possible reductions in domestic market shares is in itself likely to contribute towards an agreed solution. For these two reasons, the movement towards a fixed ratio should therefore be considerable. Thirdly, if the impasse encountered in past discussions on the final stage is to be avoided, the movement during the second stage should not be so great as to predicate the final structure. Fourthly, the movement should be of broadly comparable magnitude for all Member States. (The UK and Ireland could constitute a special case. If they use their derogation to the full, they will have to move directly to the second stage in one step at the end of 1977). These considerations, if taken alone, would suggest that the specific component in the second stage should be not less than 20% and not more than 60% of the excise.

However, the proposal to calculate the percentage of the specific component by reference to the total tax burden (excise + VAT) and to include VAT within the ad valorem component considerably modifies this judgement. All other things being equal, those countries at present applying the maximum permitted specific component will find that inclusion of VAT within the calculations will offset to some extent the reduction in the specific excise. Consequently, the adaptation required will be less in practice than it appears. By contrast, those countries at present applying the minimum permitted specific component will find that inclusion of VAT within the calculations will augment the adaptation which they are required to make in the second stage.

Consequently, a proposal for the second stage to reduce the permitted variation in the specific component (at present, between 5% and 75% of the excise, exclusive of VAT) by an equal figure at both ends, would oblige certain Member States to make a much greater adaptation than others. This imbalance could be broadly corrected by an asymmetric reduction in the specific range which would ensure comparable movements by all the Member States.

For these reasons, it is proposed that the permitted percentage range for the specific component during the second stage should be not less than 15% and not more than 50% of the total tax burden (excise + VAT). The changes in tax structures which Member States could be expected to make in response to these provisions are shown in Annex 2.

VIII. Comments on the articles

Article 1

This Article provides that account shall be taken of VAT in the inclusion of the excise, so that the specific component is determined by reference to the total tax levied (specific excise component + proportional excise component + proportional VAT).

Article 2

No comment.

Article 3

This Article introduces a new heading "Title III" concerning the special provisions applicable during the second stage of harmonization.

Article 11 (new)

The first stage of harmonization provided for in Article 7 of the Directive of 19 December 1972 has already been twice extended by 12 months, and now covers a period of 48 months up to 30 June 1977. This Article provides that the second stage shall run for $3\frac{1}{2}$ years, from 1 July 1977 to 31 December 1980.

Article 12 (new)

Paragraph 1

This paragraph incorporates the principle previously laid down in Article 8 (1) of the Directive of 19 December 1972, but also takes into account a possible change in the most popular price category for cigarettes. Such a change in the most popular price category could as well stem from a change in consumer tastes as from a change in prices. Subject to the requirement for annual review and, if necessary, amendment, the possibility of a price change requiring an immediate tax change will be avoided.

Paragraph 2

This provision replaces Article 8 (2) of the Directive of 19 December 1972, which established for the first stage of harmonization a specific component of between 5% and 75% of the total excise. Paragraph 2 provides that the specific component in the second stage shall be between 15% and 50% of the total tax burden (i.e., excise + VAT).

Paragraph 3

A similar provision is already applicable during the first stage.

Paragraph 4

This provision already applies during the first stage.

The right to exclude customs duties from the basis on which the proportional component is calculated is contrary to the general principle laid down in Article 4 (1) of the Directive of 19 December 1972. However, as a transitional measure, this right may also be retained during the second stage.

Paragraph 5

This provision already applies during the first stage.

Background data

Also attached for information are Annexes showing:-

Annex 3 : Spread of retail prices of cigarettes in each Member State.

Annex 4 : Retail price in each Member State of the most popular cigarette, and fiscal burden.

Annex 5 : Cigarette consumption, and proportion imported.

VAT on cigarettes

	on the retail price (all taxes included)
BELGIUM	5.66%
LUXEMBOURG	2 %
NETHERLANDS	12.28%
GERMANY	9.91%
FRANCE	6.96%
ITALY	15.25%
DENMARK	13.04%
UNITED KINGDOM	7.4 %
IRELAND	6.32%

ANNEX II

Application by the Member States of the directive of 19.12.72
(first stage of harmonisation) and the situation resulting
from the draft directive (second stage of harmonisation)

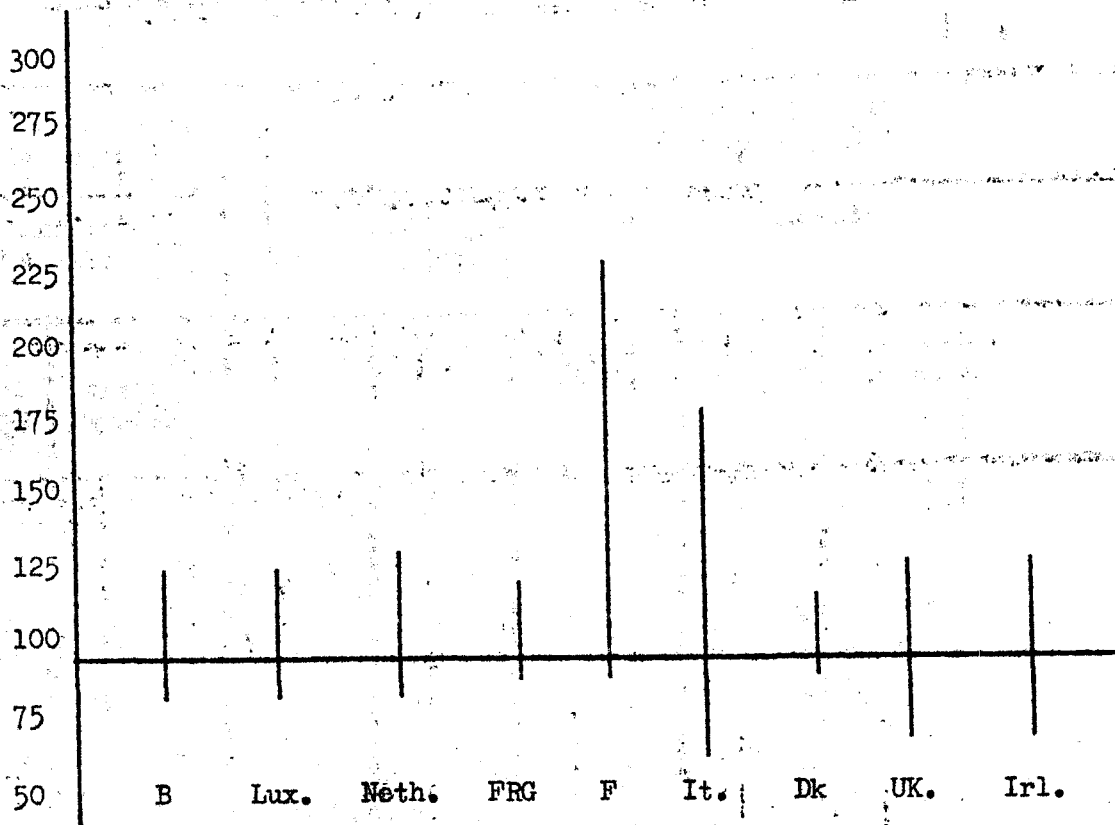
Respective parts of the specific and ad valorem components⁽¹⁾ in
the taxation of cigarettes in the most popular price category

Situation at 1.9.75 (First stage)					Proposed for 1.7.77 ⁽³⁾ (Second stage)		
Excise		VAT		Total tax (Excise + VAT)		Total tax (Excise + VAT)	
Specific between 5% and 75%	Ad.val. between 95% and 25%	Ad. val. 100%	Spec.	Ad. val.	Specific between 15% and 50%	Ad. val. between 85% and 50%	
(%)	(%)		(%)	(%)	(%)	(%)	
France	5	95	4.5	95.5	15	85	
Italy	5	95	4	96	15	85	
Belgium	5.3	94.7	4.8	95.2	15	85	
Luxembourg	4.8 ⁽²⁾	95.2	4.7	95.3	15	85	
Netherlands	4.6 ⁽²⁾	95.4	3.7	96.3	15	85	
F.R.G.	74.1	25.9	63.6	36.4	50	50	
Denmark	74.4	25.6	62.8	37.2	50	50	
United Kingdom	100 ⁽⁴⁾	-	89.8	10.2	-(4)	-(4)	
Ireland	100 ⁽⁴⁾	-	91	9	-(4)	-(4)	

- (1) The specific component is a fixed sum per cigarette.
The proportional component is calculated on the retail price.
- (2) In the Grand-Duchy of Luxembourg and in the Netherlands the specific component no longer represents 5% of the excise.
- (3) On the assumption that each Member State makes the smallest change permissible.
- (4) At present in the United Kingdom and Ireland, the excise is based on the weight of the raw tobacco (derogation until 31.12.77).

Spread of retail prices for cigarettes in
each Member State

(Index 100 = most popular price class)



Cigarettes of the most popular price class (index 100) represented
in 1974:

Belgium	79%	of cigarette sales
Luxembourg	60%	" " "
Netherlands	75%	" " "
Germany	65%	" " "
France	56%	" " "
Italy	38%	" " "
Denmark	90%	" " "
United Kingdom	26%	" " "
Ireland	30%	" " "

Situation in
August 1975

Retail prices of cigarettes of the most
popular price class and tax burden on these cigarettes

Retail price per 20 cigarettes
in u.a.

Tax burden (excise + VAT)
in u.a.

Denmark :	9.90 Kr. = 1.40 u.a.
Germany :	2.30 DM = 0.75 u.a.
UK :	41.5 p. = 0.72 u.a.
Ireland:	34 p. = 0.59 u.a.
Netherlands:	2 Fl.(25) = 0.51 u.a.(20)
Belgium:	27 Fr.(25) = 0.47 u.a.(20)
Italy:	350 Lire = 0.43 u.a.
Luxembourg:	21 Fr.(25) = 0.41 u.a.(20)
France:	1.70FF. = 0.33 u.a.

Denmark :	83.8% = 1.17 u.a.
Germany :	70% = 0.53 u.a.
UK :	70.3% = 0.51 u.a.
Ireland :	70.3% = 0.41 u.a.
Netherlands:	67% = 0.34 u.a.
Italy :	74.4% = 0.32 u.a.
Belgium :	67% = 0.31 u.a.
France :	72.7% = 0.24 u.a.
Luxembourg:	60.8% = 0.22 u.a.

Consumption of cigarettes (millions) in the Community

	1973			1974			% imported
	Total	Part supplied by all sources	of which EEC	Total	Part supplied by all sources	of which EEC	
Belgium - Luxembourg	20,236	2,009	2,002	20,243	2,051	2,047	10.1%
Netherlands	23,423	5,111	3,612	23,423	8,074	7,745	34.4%
Germany	125,461	970	779	128,017	1,255	1,005	0.9%
France	75,379	5,695	5,675	80,492	6,554	6,513	8.1%
Italy	80,151	14,186	14,144	87,489	21,455	21,406	24.5%
United Kingdom	137,400	1,941	1,019	137,000	2,020	1,533	1.5%
Ireland	6,802	128	100	7,405	298	215	4%
Denmark	7,608	1,154	500	6,796	789	350	11.6%
Community total	476,460	32,194	27,831	490,875	42,496	40,814	8.65%

World (estimate) 3,500,000

More than 86% of imports
are of Community origin

More than 96% of imports
are of Community origin

1-4

Proposal for a Council Directive of ...
amending Directive No. 72/464/EEC
on taxes other than turnover taxes which affect
the consumption of manufactured tobacco

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community,
and in particular Articles 99 and 100 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas, in accordance with Council Directive No. 72/464/EEC⁽¹⁾ of
19 December 1972, as amended by Directives Nos. 74/318/EEC of 25 June 1974⁽²⁾
and 75/ /EEC of 18 December, 1975⁽³⁾ on taxes other than turnover
taxes which affect the consumption of manufactured tobacco, the Council
must, before 30 June 1976, adopt a Directive laying down the special
criteria applicable after the first stage, covering, subject to
Article 1 (4), a period of 48 months from 1 July 1973;

Whereas, the special criteria applicable during the first stage have
permitted an initial approximation of the structures of the excise duties
on cigarettes in seven of the nine Member States, without the tax revenue
of the Member States or the conditions on their markets being appreciably
affected;

(1) OJ No. L 303, 31 December 1972, p. 1 and

(2) OJ No. L 180, 3 July 1974, p. 30

(3) OJ No.

Whereas the United Kingdom and Ireland, by virtue of Article 12 of Council Directive No. 72/464/EEC of 19 December 1972, may defer application of the above Directives until 31 December 1977 and that these Directives have not yet, therefore, had any practical effect in those two Member States;

Whereas the structure of the excise duty on cigarettes must include, in addition to a specific component calculated per unit of the product, a proportional component based on the retail selling price, inclusive of all taxes; whereas account should be taken of the fact that the VAT applicable to cigarettes has the same effect as a proportional excise duty by fixing the relationship between the specific component of the excise and the total tax burden;

Whereas it is necessary to lay down the special provisions applicable during a second stage in such manner as to orientate the excises applied to cigarettes by the Member States towards a common structure;

Whereas the structure of the excise duty on manufactured tobacco other than cigarettes will be determined at a later date;

HAS ADOPTED THIS DIRECTIVE:

./.

Article 1

Article 4 (3) of Council Directive No. 72/464/EEC of 19 December 1972, is amended as follows:

- "3. At the final stage of harmonization of structures, the same ratio shall be established for cigarettes in all Member States between the specific excise duty and the sum of the proportional excise duty and of VAT, in such a way that the range of retail selling prices reflects fairly the difference in the manufacturers' delivery prices".

Article 2

Title III and Articles 11, 12 and 13 of the Council Directive of 19 December 1972 become Title IV and Articles 13, 14 and 15 respectively.

Article 3

The following new Title III is inserted in the Council Directive of 19 December 1972:

"Title III

Special provisions applicable during the second stage
of harmonization

Article 11

1. Without prejudice to the application of Article 1 (4), the second stage of harmonization of the structures of the excise duty on manufactured tobacco shall cover the period from 1 July 1977 to 31 December 1980.
2. During this second stage of harmonization, Article 12 shall be applicable.

Article 12

1. The amount of the specific excise duty levied on cigarettes shall be established by reference to cigarettes in the most popular price category according to the data available on 1 January of each year, beginning with 1 January 1977.
2. The specific component of the excise duty may not be lower than 15% or higher than 50% of the amount of the total tax burden resulting from the aggregation of the proportional excise duty, the specific excise duty and the VAT levied on these cigarettes.
3. If the excise duty or the VAT levied on the price class referred to above is amended after 1 January 1977, the amount of the specific excise duty shall be established by reference to the new total tax burden on the cigarettes referred to in paragraph 1.
4. In derogation from Article 4 (1), each Member State may exclude customs duties from the basis of calculation of the proportional excise duty on cigarettes.
5. The Member States may levy on cigarettes a minimum excise duty the amount of which may not, however, be higher than 90% of the aggregate amount of the proportional excise duty and the specific excise duty which they levy on the cigarettes referred to in paragraph 1."

Article 4

This Directive is addressed to the Member States.

Done at Brussels,

for the Council,
The President.