



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 15.05.1998
COM(1998) 320 final

98/0189 (CNS)

Proposal for a

COUNCIL DIRECTIVE

amending Directive 92/79/EEC on the approximation of taxes on cigarettes, Directive 92/80/EEC on the approximation of taxes on manufactured tobacco other than cigarettes and Directive 95/59/EC on taxes other than turnover taxes which affect the consumption of manufactured tobacco

(presented by the Commission)

COMMISSION REPORT ON THE STRUCTURE AND RATES OF EXCISE DUTY LAID
DOWN BY COUNCIL DIRECTIVE 92/79/EEC OF 19 OCTOBER 1992 ON THE
APPROXIMATION OF TAXES ON CIGARETTES AND BY COUNCIL DIRECTIVE
92/80/EEC OF 19 OCTOBER 1992 ON THE APPROXIMATION OF TAXES ON
MANUFACTURED TOBACCO OTHER THAN CIGARETTES

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Explanatory memorandum

1. COMMISSION REPORT ON THE RATES AND STRUCTURE OF EXCISE DUTIES ON MANUFACTURED TOBACCO

This proposal for a Directive proposes a number of technical adjustments to existing Community legislation on the taxation of manufactured tobacco which the Commission's review of the structure and rates of excise duty on tobacco has shown to be necessary.

The review was conducted in accordance with Article 4 of Council Directive 92/79/EEC of 19 October 1992 on the approximation of taxes on cigarettes¹ and Article 4 of Council Directive 92/80/EEC of 19 October 1992 on the approximation of taxes on manufactured tobacco other than cigarettes,² which state that the rates and structure of excise duties are to be reviewed at two-yearly intervals. The Commission is to present a report which may or may not be accompanied by proposals revising the Directives. The conclusions of the second review are set out in the attached Commission report.

The first review in 1995³ showed that there was no need for any short-term adaptations to the structure and rates of excise duty on manufactured tobacco to ensure the smooth operation of the single market. However, the Commission concluded that a wide-ranging consultation exercise should be held. During the consultations neither the national authorities nor the trade organisations came out in favour of fundamental change to the existing tax structure. The Commission therefore took the view that, although it was not expedient to propose fundamental changes in the structure or rates of excise duty, there was a need for certain technical adjustments.

The report takes into account the smooth operation of the single market, the real value of excise-duty rates and the wider objectives of the Treaty.

2. OPERATION OF THE SINGLE MARKET

The rates of duty on cigarettes in different Member States still differ widely. Despite this, no requests for closer convergence were made during the consultation exercise. However, it was generally agreed that the technical problems encountered in applying the existing rules need to be remedied.

The overall minimum excise duty on cigarettes is expressed as a percentage of the retail selling price. It is particularly difficult to implement the 57% rule when the level of taxation in a Member State is very close to 57% and when changes are planned in the retail selling price or the rate of VAT. Another issue is the way in which the 57% rule is applied in practice in the Member States. While bearing in mind what is feasible, a

¹ Council Directive 92/79/EEC of 19 October 1992 on the approximation of taxes on cigarettes (OJ L 316, 31.10.92, p. 8).

² Council Directive 92/80/EEC of 19 October 1992 on the approximation of taxes on manufactured tobacco other than cigarettes (OJ L 316, 31.10.1992, p. 10).

³ COM(95) 285 final, 13.9.95.

technical adjustment should be made to Community legislation so as to avoid divergent interpretations among Member States. The aim is to allow Member States greater leeway to adjust the incidence of the overall minimum excise rate in the event of changes in the retail selling price of cigarettes in the most popular price category or changes in VAT rates. Similarly, it should be made easier to adjust the specific component of excise duty in cases where that component is expressed as a percentage of the retail selling price.

The way in which rules on the taxation of cigars are applied has recently been investigated. In one Member State the rules were interpreted as allowing the application of *ad valorem* rates to cigars, subject to fixed specific minimum rates. Some Member States feel that such an approach has its advantages and would be interested in incorporating similar measures into their legislation if that were permissible under Community law. The effect of such a measure is to increase the relative incidence of taxation on the cheapest products. Similar provisions are already in place for cigarettes and hand-rolling tobacco. The Commission has therefore concluded that it would be desirable for the Member States to have the option of levying a minimum rate of excise duty on cigars and smoking tobacco as well.

3. REAL VALUE OF EXCISE-DUTY RATES

The review also looked at the real value of excise-duty rates. National administrations generally take inflation into account when drafting their budgets. It can be assumed that, all other things being equal, they will usually raise excise-duty rates in line with inflation. Since the minimum excise duty on cigarettes is expressed as a percentage of the retail selling price, it tracks inflation automatically and so does not require any such adjustment. After the Member States' decision a few years ago to opt for specific excise duties on cigars, smoking tobacco and other tobacco, it is fair to assume that the increases in recent years have taken account of inflation. Moreover, an inflation-based adjustment in the minimum rates expressed as a specific amount is needed to maintain the ratio between the specific and the *ad valorem* components which was established when the rates were initially set.

4. WIDER OBJECTIVES OF THE TREATY

Given the criteria laid down for achieving economic and monetary union, it is essential that Community excise-duty policy, while aimed primarily at ensuring the smooth operation of the single market, should guarantee revenue receipts and sound conditions at national level and should be consistent with the wider policies of the European Union. Where manufactured tobacco products are concerned, particular attention must be paid to the health-protection aspects and to the relationship between such protection and the price of these products.

Tobacco is at present very heavily taxed in most Member States. This is justified on public-health grounds since it helps discourage consumption. However, the relatively high tax on tobacco also encourages fraud. Consequently, provided that they comply with the minimum amounts laid down in Directives 92/79/EEC and 92/80/EEC, Member States are at liberty to determine their own levels of taxation and to take account of factors such as health and fraud.

Under the circumstances, and given that the minimum rate for cigarettes is expressed as a percentage, the Commission has decided not to propose any changes in minimum rates.

5. FREQUENCY OF REVIEWS

As they stand, Directives 92/79/EEC and 92/80/EEC provide for two-yearly reviews of the structure and rates of excise duty. In the Commission's view, a two-year period is not long enough to allow changes in Community legislation to be properly evaluated. A five-year period would be a more appropriate length of time to assess the operation of the single market and the impact of any amendments to legislation.

Explanation of the articles

Article 1

Article 1 amends certain provisions of Directive 92/79/EEC on the approximation of taxes on cigarettes.

Point 1

A new *Article 2a* is inserted. The purpose is to allow the Member States greater latitude to adjust the incidence of the overall minimum excise duty in the event of a change in the retail selling price of cigarettes in the most popular price category.

The Commission has observed a number of differences in the manner in which the 57% rule is applied in the Member States. Some Member States agree with the Commission that Article 2 of Directive 92/79/EEC should be interpreted literally and strictly adhered to. Checking compliance with the rule that the minimum incidence of excise duty must not fall below 57% is not linked to the date of 1 January and need not be a once-yearly exercise only. On the contrary, compliance with the 57% rule is an ongoing requirement which must be met whenever there is a change in retail selling prices, while at the same time the most popular price category, which is established once a year only, must be respected. Other Member States disagree with this interpretation, arguing that compliance with the 57% rule should be checked once a year only. A few Member States agree with the strict interpretation but verify the incidence of excise-duty rates only once a year.

In practice, it would seem that continuous verification would be impracticable and would not even be the best approach. Moreover, there are other interpretations which, though equally valid, are not entirely consistent with the strict interpretation. However, a situation in which different practices based on divergent interpretations of the relevant legislation coexist can hardly be maintained indefinitely. In so far as a flexible interpretation can more readily take account of what is practicable, the Commission has opted for a technical adjustment to Community legislation.

This technical adjustment is incorporated in *paragraph 1*. It gives a certain amount of leeway to those Member States which interpret the legislation strictly, without however calling into question the vital role played by the existing rules. Accordingly, Member States may delay adjusting the incidence of the overall minimum excise duty until 1 January of the second year following the change.

The purpose of *paragraph 2* is to reduce the automatic impact of any increase in the standard VAT rate on the overall taxation of cigarettes.

Excise duty includes a component expressed as a percentage of the goods' retail selling price, inclusive of VAT. VAT itself is also applied to the value of the goods inclusive of excise duty. A straightforward increase in the VAT rate thus leads to an increase in the absolute burden of excise duty which, in turn, increases the base to which the new VAT rate is applied. Moreover, owing to the change in the relative proportions of the different components of the retail selling price, overall excise duty may fall below 57% of the new retail selling price. This makes it necessary to raise excise duty again, thus increasing the

tax base to which the new VAT rate is applied, and so on. This process is known in the industry as 'the cascade effect'.

The Member States are currently required to apply the standard rate of VAT to manufactured tobacco. Under current VAT rules, Member States are limited, in principle, to one standard rate and one reduced rate, the scope of the latter being restricted. Consequently, if a Member State decides to raise its standard rate, it is obliged to apply the higher rate to all goods and services subject to the standard rate.

There is no other sector in which an increase in the VAT rate has so great an impact. National governments may pursue the policies of their choice, but they should not be forced to increase excise duty for purely mechanical reasons, without any particular aim in mind.

The Commission therefore proposes that the Member States be authorised, even if only temporarily (see paragraph 3 below) to neutralise the impact on excise duty of an increase in the VAT rate, even if, as a result of such an adjustment, the incidence of the overall minimum excise duty temporarily falls below 57% of the retail selling price of cigarettes in the most popular price category.

The aim of *paragraph 3* is to limit the length of time during which Member States can reduce the impact of VAT increases.

Paragraph 2 is not designed to authorise situations in which the incidence of the overall minimum excise duty remains lower than 57% of the retail selling price of cigarettes in the most popular price category in the long term. The flexibility which the Member States will enjoy must not result in unfair competition between them and must be consistent with the smooth operation of the single market.

The Commission thus takes the view that a temporary derogation from the incidence of the overall minimum excise rate is acceptable, provided that it applies for a limited time only. It therefore proposes that Member States which exercise the neutralisation option readjust the incidence of the overall minimum excise duty to the level of 57% of the retail selling price of cigarettes in the most popular price category and that they do this at the latest by 1 January of the second year following the year in which adjustment took place.

Point 2

Article 4 of Directive 92/79/EEC currently states that the Commission must examine the structure and rates of excise duty on cigarettes every two years.

In the Commission's view, a two-year period is not long enough for changes in Community or national legislation to be properly evaluated. A five-year period would be more appropriate in order to assess the operation of the single market and the impact of any amendments to legislation.

Article 4 therefore provides for a review at five-year instead of two-year intervals. The next review is due to take place by 31 December 2002 at the latest. The Commission is, of course, at liberty to put forward proposals before the end of the five-year period if it judges this to be necessary.

Article 2

Article 2 amends a number of provisions in Directive 92/80/EEC on the approximation of taxes on manufactured tobacco other than cigarettes.

Point 1

The Commission recently investigated the way in which the rules on the taxation of cigars and hand-rolling tobacco are applied. Directive 92/80/EC stipulates that the Member States must apply to cigars and cigarillos, hand-rolling tobacco and other types of smoking tobacco an excise duty which may be *ad valorem*, specific or composite. In addition, Member States may levy a minimum excise duty on hand-rolling tobacco, provided that this does not increase the total tax burden to more than 90% of the total tax burden on hand-rolling tobacco in the most popular price category.

The application of *ad valorem* or specific rates to cigars and smoking tobacco, subject to fixed specific minimum amounts, is not allowed under existing legislation.

However, in one Member State the rules have been interpreted as allowing the application of *ad valorem* rates to cigars and smoking tobacco, subject to a fixed specific minimum amount. The Commission takes the view that this interpretation does not comply strictly with the Directive. However, even if a technical infringement exists, the approach taken by the Member State in question has not had any adverse effects. The fact that it is illegal for cigars but completely legal for cigarettes and hand-rolling tobacco makes it more difficult to defend or justify the arrangements laid down in the Directive for cigars and smoking tobacco. The Commission has concluded from this that existing legislation must be adapted so as to give Member States the opportunity to levy a minimum excise duty on cigars, cigarillos and smoking tobacco as well.

The minimum excise duty on cigars, cigarillos, hand-rolling tobacco and other types of smoking tobacco is expressed both as a percentage of the retail selling price and as a specific amount. Leaving all other considerations aside, it should be noted that the gap between these two factors widens over time with rising inflation since the proportional rate automatically tracks changes in the retail selling price.

In the Commission's view, the specific minimum amounts, expressed in ecus, should now be adjusted in line with inflation, so as to maintain the ratio established between the two components when the rates were set initially.

The Commission proposes that the minimum rates be increased in two stages.

The first stage would be to adjust for inflation between 1992 (the year in which the minimum rates were fixed) and 1998 (the year in which the rates were reviewed). According to Eurostat data, the overall rate of inflation during this period was some 18.5%. If we apply this percentage to the minimum rates and round up to the next unit, we obtain the following minimum rates:

- ECU 9 for cigars and cigarillos,
- ECU 24 for hand-rolling tobacco, and
- ECU 18 for other types of smoking tobacco.

The increased rates should take effect as of 1 January 1999.

Since the Commission is proposing here that reviews be carried out at five-yearly rather than two-yearly intervals, a second increase in the level of rates expressed as a specific amount is needed. The purpose of this second stage is to allow for the inflation forecast of 4.5% for the period from 1 January 1999 to 31 December 2000. If this percentage is applied to the minimum rates calculated above and if the results are rounded up to the next unit, we obtain the following minimum rates:

- ECU 10 for cigars and cigarillos,
- ECU 25 for hand-rolling tobacco, and
- ECU 19 for other types of smoking tobacco.

These minimum rates will take effect as of 1 January 2001.

Point 2

Article 4 of Directive 92/80/EEC states that the Commission must examine the rates of duty on cigars, cigarillos, hand-rolling tobacco and other types of smoking tobacco every two years.

The Commission proposes that Article 4 be amended to take account of the change in the frequency of reviews of the rates and structure of excise duties on cigarettes (see Article 4 of Directive 92/79/EEC and point 1 (observations concerning the second paragraph) relating to Article 1 above).

Article 3

Article 3 amends a number of provisions laid down in Directive 95/59/EC on taxes other than turnover taxes which affect the consumption of manufactured tobacco.

Point 1

Paragraph 2a is added to this Article so as to give the Member States more latitude to adjust the specific component of excise duty in the event of a change in the retail selling price of cigarettes in the most popular price category.

In introducing this degree of flexibility, which is comparable to the flexibility provided for in applying the 57% rule concerning the incidence of the overall minimum excise duty, the approach chosen for the taxation on cigarettes is consistent.

The Member States are authorised to delay adjustment of excise duty to the required levels until 1 January of the second year following that in which the retail selling price of cigarettes in the most popular price category was changed, and this as regards both the specific component of excise duty and the incidence of the overall minimum excise duty.

Point 2

Paragraph 3 states that the Member State in question is required immediately to adjust the amount of specific excise duty in line with the new total tax burden on cigarettes in the most popular price category only if the rate of excise duty itself is changed. Adjustments following changes in VAT are dealt with in paragraph 2a.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99 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 its first report on the structure and rates of excise duties,¹ drawn up in accordance with the provisions of Council Directive 92/79/EEC² and Council Directive 92/80/EEC,³ the Commission merely drew attention to certain difficulties encountered in implementing the Directives without proposing any precise solutions;

Whereas a consultation process involving national authorities, business representatives and interest groups has since taken place;

Whereas the first stage in this consultation process was the Lisbon Conference, the purpose of which was to assess the performance of the present Community arrangements and to assist the Commission in its task of planning future excise-duty policy;

Whereas the consultation process has led to a second Commission report;

Whereas the consultation process revealed difficulties in applying the 57% minimum incidence rule;

Whereas the rules must be interpreted and implemented more uniformly in the Member States if the single market is to operate smoothly;

Whereas, moreover, rules which can be implemented more easily in practice must be established if the single market is to operate smoothly;

Whereas the Member States should none the less be allowed sufficient flexibility to identify and implement policies tailored to national circumstances;

¹ COM(95) 285 final, 13.9.85.

² OJ L 316, 31.10.1992, p. 8.

³ OJ L 316, 31.10.1992, p. 10.

Whereas, for practical reasons, the Member States must be allowed some flexibility to adjust the incidence of the overall minimum excise duty in line with certain changes, including those in VAT rates;

Whereas Member States must be given the option of neutralising the impact of changes in the VAT rate on the overall minimum excise duty;

Whereas the existence of this option must not lead to distortions of competition or to malfunctioning of the single market;

Whereas the options open to the Member States regarding the application of the Directives must be limited over time;

Whereas there is nothing to prevent Member States from being authorised to apply a minimum excise duty to cigars, cigarillos and smoking tobacco where such an option already exists for cigarettes and hand-rolling tobacco;

Whereas there is a need to establish a regular review procedure;

Whereas the present period of two years is too short for changes in the legislation of the Member States to be properly evaluated;

Whereas, for this reason, reviews must take place at five-yearly intervals;

Whereas, in order to avoid a fall in the value of the Community minimum rates of duty on cigars, cigarillos and hand-rolling tobacco, a schedule of increases is needed;

Whereas, therefore, Council Directives 92/79/EEC, 92/80/EEC and 95/59/EC,⁴ need to be amended,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Directive 92/79/EEC is hereby amended as follows:

1. A new article Article 2a is inserted:

“Article 2a

1. When a change in the retail selling price of cigarettes in the most popular price category occurs in a Member State, thereby bringing the incidence of the overall minimum excise duty below the level specified in the first paragraph of Article 2, the Member State in question may refrain from adjusting the incidence of the overall minimum excise duty until not later than 1 January of the second year following that in which the change occurs.

2. When a Member State increases the rate of value added tax on cigarettes, it may reduce the incidence of the overall minimum excise duty by an amount which, expressed as a percentage of the retail selling price, is equal to the increase in the rate of value added

⁴ OJ L 291, 6.12.1995, p. 40.

tax, also expressed as a percentage of the retail selling price, even if such an adjustment has the effect of reducing the incidence of the overall minimum excise duty to below the level laid down in Article 2.

3. If, in accordance with paragraph 2, a Member State has reduced the incidence of the overall minimum excise duty to a level below that laid down in the first paragraph of Article 2, it shall raise that incidence so as to reach at least that level not later than 1 January of the second year after that in which the reduction took place.”

2. Article 4 is replaced by the following:

“Article 4

Every five years, and for the first time not later than 31 December 2002, the Council, acting on the basis of a report and, where appropriate, a proposal from the Commission, shall examine the overall minimum excise duty laid down in Article 2 and in Article 3(2) and the structure of excise duties as defined by Article 16 of Council Directive 95/59/EC and, acting unanimously after consulting the European Parliament, shall adopt the necessary measures. The report by the Commission and the examination by the Council shall take into account the proper functioning of the internal market and the wider objectives of the Treaty.”

Article 2

Directive 92/80/EEC is hereby amended as follows:

1. Article 3(1) is replaced by the following:

“1. Not later than 1 January 1993, Member States shall apply an excise duty which may be:

(a) either an *ad valorem* duty calculated on the basis of the maximum retail selling price of each product, freely determined by manufacturers established in the Community and by importers from non-member countries in accordance with Article 9 of Directive 95/59/EC,

(b) or a specific duty expressed as an amount per kilogram or for a given number of items in the case of cigars and cigarillos,

(c) or a mixture of both, combining an *ad valorem* element and a specific element.

In cases where excise duty is either *ad valorem* or mixed, Member States may levy a minimum excise duty expressed in the same way as the excise duty referred to at (b).

As of 1 January 1999, the overall excise duty expressed as a percentage, as an amount per kilogram or for a given number of items shall be at least equivalent to the rates or minimum amounts laid down for:

- cigars or cigarillos: 5% of the retail selling price inclusive of all taxes, or ECU 9 per 1000 items or per kilogram
- fine-cut smoking tobacco intended for the rolling of cigarettes: 30% of the retail selling price inclusive of all taxes, or ECU 24 per kilogram

- other smoking tobaccos: 20% of the retail selling price inclusive of all taxes, or ECU 18 per kilogram.

As of 1 January 2001 the amounts of ECU 9 for cigars and cigarillos, ECU 24 for fine-cut smoking tobacco intended for the rolling of cigarettes and ECU 18 for other smoking tobaccos shall be replaced by ECU 10, ECU 25 and ECU 19 respectively.”

2. Article 4 is replaced by the following:

“Article 4

Every five years, and for the first time not later than 31 December 2002, the Council, acting on the basis of a report and, where appropriate, a proposal from the Commission, shall examine the rates of duty laid down herein and, acting unanimously after consulting the European Parliament, shall adopt the necessary measures. The report by the Commission and the examination by the Council shall take into account the proper functioning of the internal market, the real value of the rates of duty and the wider objectives of the Treaty.”

Article 3

Article 16 of Directive 95/59/EC is hereby amended as follows:

1. The following paragraph 2a is inserted:

“2a. By way of derogation from paragraph 2, where, for instance, due to a variation in VAT rates, a change in the retail selling price of cigarettes in the most popular price category occurs in a Member State, thereby bringing the specific component of the excise duty, expressed as a percentage of the total tax burden, below 5% or above 55% of the total tax burden, the Member State in question may refrain from adjusting the amount of the specific excise duty until not later than 1 January of the second year following that in which the change occurs.”

2. In paragraph 3, the phrase “If the excise duty or the turnover tax levied” is replaced by “If the excise duty levied”.

Article 4

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 1 January 1999. They shall forthwith inform the Commission thereof.

When Member States adopt these provisions, they shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 5

This Directive shall enter into force on the twentieth day following its publication in the Official Journal of the European Communities.

Article 6

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

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MANUFACTURED TOBACCO OTHER THAN CIGARETTES

(presented pursuant to Article 4 of Directive 92/79/EEC and Article 4 of Directive 92/80/EEC)

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Summary

Chapter 1 describes the current Community excise-duty arrangements, which entered into force on 1 January 1993. They provide for common taxation structures in the Member States and lay down a system of minimum rates for manufactured tobacco and harmonised procedures for the holding and movement of excisable goods.

Chapter 2 draws attention to the fact that the Directives on the approximation of excise-duty rates lay down the obligation to examine the structure and rates of such duties. It refers to the Commission's first report and the Lisbon Conference of November 1995, which together led to the current review.

Chapter 3 examines the legislation currently in force from the following viewpoints: the smooth operation of the single market, the real value of excise-duty rates and the wider objectives of the Treaty. Two important aspects of the smooth operation of the single market are examined. Firstly, the relatively high taxes on tobacco and the disparities between the rates applicable in the different Member States inevitably have an impact on fraud and smuggling. Secondly, the practical application of the rules on tobacco can sometimes pose difficulties in certain Member States. It would therefore be a good thing to have more flexibility in this area, without necessarily altering the structure of excise duties. As regards the real value of such duties, care must be taken to ensure that the minimum rates expressed as specific amounts are kept in line with inflation. Finally, as regards the wider objectives of the Treaty, particular emphasis must be placed on the objective of health protection and the link with the price of manufactured tobacco.

Chapter 4 sets out the conclusions of the review of the structure and rates of excise duties.

I. Community excise-duty arrangements

1. GENERAL REMARKS

- 1.1 Excise duties are taxes on the consumption of goods such as cigarettes, cigars, cigarillos and smoking tobacco. Excise duty on tobacco is a major source of revenue for the Member States, accounting for between 0.39% and 1.58% of GDP (see Annex A). Excise-duty rates vary a great deal from one Member State to another, depending on a number of factors such as the product's relative position on the market and national policies.
- 1.2 The current arrangements were introduced on 1 January 1993. They are the outcome of discussions which started in 1985 with the White Paper on completing the internal market, in which the Commission proposed full harmonisation of excise duties on manufactured tobacco. However, the Council chose not to take this approach and harmonisation extended only to taxation structures. Minimum rates were also set.
- 1.3 Excisable goods move between Member States under duty-suspension arrangements.¹ Businesses wishing to move goods under such arrangements must be registered in the Member State where they are established and consignments must be accompanied by an administrative document. In accordance with the principles of the single market, private individuals enjoy greater freedom to purchase duty-paid goods in the Member State of their choice now that the limited travellers' allowances have been abolished.

2. EXCISE DUTY ON CIGARETTES

- 2.1 Under current Community rules², excise duties levied on cigarettes by the Member States must include a proportional component (calculated on the basis of the maximum retail selling price) and a specific component (levied on each unit of the product). These two components, taken together, must account for at least 57% of the retail selling price, including tax, of cigarettes belonging to the most popular price category. The specific component of excise duty must not be lower than 5% or higher than 55% of the total tax burden resulting from the aggregation of the proportional and the specific excise duty and of the turnover tax levied on such cigarettes. Once these two components have been established for this category of cigarettes, they are applied to cigarettes of all price categories.

¹ Council Directive 92/12/EEC of 25 February 1992 on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products (OJ L 76, 23.3.92, p.1), as amended by Directives 92/108/EEC of 14 December 1992 (OJ L 390, 31.12.92, p. 124) and 94/74/EC of 22 December 1994 (OJ L 365, 31.12.94, p. 46).

² Council Directive 95/59/EC of 27 November 1995 on taxes other than turnover taxes which affect the consumption of manufactured tobacco (OJ L 291, 6.12.95, p. 40).

Council Directive 92/79/EEC of 19 October 1992 on the approximation of taxes on cigarettes (OJ L 316, 31.10.92, p. 8).

- 2.2 There has been much discussion over a number of years of the ratio which should obtain between the proportional component and the specific component. The effect of *ad valorem* taxation is to increase price differences before tax. This is why *ad valorem* taxation has traditionally been favoured by Member States which manufacture cigarettes using domestically produced tobacco. Such cigarettes are often produced by state monopolies and are generally cheaper than cigarettes made using imported tobacco. Specific taxation is generally more common in those Member States which do not cultivate tobacco.
- 2.3 Article 4 of Council Directive 92/79/EEC of 19 October 1992 on the approximation of taxes on cigarettes states that every two years the Council, acting on the basis of a report and, where appropriate, a proposal from the Commission, must examine the overall minimum excise duty and the structure of excise duties and, acting unanimously after consulting the European Parliament, must adopt the necessary measures. The Commission's report and the Council's review must take into account the smooth functioning of the single market and the wider objectives of the Treaty.

3. EXCISE DUTY ON MANUFACTURED TOBACCO OTHER THAN CIGARETTES

- 3.1 The Community rules currently in force³ relate to cigars and cigarillos, fine-cut smoking tobacco intended for the rolling of cigarettes, and other smoking tobacco. Article 3 of Directive 92/80/EEC lays down minimum rates of excise duty for these products. Member States can levy proportional excise duty, calculated on the basis of maximum retail selling prices, specific excise duty or composite excise duty, subject to certain defined limits.
- 3.2 The current minimum rates are as follows:
- cigars and cigarillos: 5% of the retail selling price or ECU 7 per 1000 items or per kilogram;
 - hand-rolling tobacco: 30% of the retail selling price or ECU 20 per kilogram.
 - other smoking tobacco: 20% of the retail selling price or ECU 15 per kilogram.

At all events, Member States can opt for a wholly proportional or a wholly specific excise duty, or a combination of both types.

- 3.3 Article 4 of Council Directive 92/80/EEC of 19 October 1992 on the approximation of taxes on manufactured tobacco other than cigarettes states that every two years, the Council, acting on the basis of a report and, where appropriate, a proposal from the Commission, must examine the rates of duty laid down and, acting unanimously after consulting the European Parliament, adopt the necessary measures. The report by the Commission and the review by the Council must take into account the smooth functioning of the single market, the real value of the rates of duty and the wider objectives of the Treaty.

³ Council Directive 92/80/EEC of 19 October 1992 on the approximation of taxes on manufactured tobacco other than cigarettes (OJ L 316, 31.10.92, p. 10).

II. Review of structure and rates of excise duty

1. GENERAL REMARKS

- 1.1 As stated above, the Directives on the approximation of excise rates stipulate that excise-duty rates and the structure of excise duty are to be reviewed every two years. The Commission is required to present a report, which may or may not be accompanied by proposals for revising the Directives.

2. FIRST COMMISSION REPORT

- 2.1 In 1995 the Commission presented its first report, which, in addition to tobacco, dealt with alcoholic beverages and mineral oils.⁴
- 2.2 That review did not result in any proposals for amending existing legislation concerning excise duty on tobacco. It simply comprised an analysis of experience gained between 1993 and 1995 and a description of potential difficulties, but did not propose any detailed solutions. The Commission felt that a more in-depth review should be conducted of the structure of excise duty on cigarettes and the taxation of hand-rolling tobacco, involving consultation of national administrations, business and interest groups. The aim was to facilitate a more comprehensive analysis of all the aspects of, and the consequences which might ensue from, any changes in the excise-duty arrangements. The Commission also sought to monitor more closely the impact of the 57% rule in the Member States and to put forward an appropriate proposal if it should transpire that this system distorted the operation of the single market.
- 2.3 On 19 September 1996 Parliament adopted its opinion on the Commission's review and called on the Commission to draw up proposals for legislation to resolve the problems identified by its 1995 review.

3. THE LISBON CONFERENCE OF NOVEMBER 1995

- 3.1 As part of the process of consultation of interested parties, the Commission decided to hold a Conference on excise duty in Lisbon in November 1995. This was the first stage of an ongoing consultation process. The Conference's aim was to evaluate the operation of the Community excise-duty arrangements, which had been in force since January 1993, and in particular to assist the Commission in its task of planning future excise-duty policy. The main topics dealt with were the operation of the single market in relation to excisable goods, the role of excise duties in generating tax revenue and their possible use in other policy areas.
- 3.2 It emerged at the above Conference that businesses from the northern Member States, represented by the Confederation of European Community Cigarette Manufacturers (CECCM), took a somewhat different approach to matters such as the interpretation of the 57% rule from that of producers from the southern

⁴ COM(95)285 final, 13.9.95.

Member States, represented by the *Groupe des Industries du Tabac de l'Europe du Sud* (GITES).

III. Scope of the second review

1. GENERAL

- 1.1 The report must examine the smooth operation of the single market, the real value of excise-duty rates and the wider objectives of the Treaty.
- 1.2 The first review of the structure and rates of excise duty demonstrated that a change in the structure of duty on cigarettes was not necessary to guarantee the smooth operation of the single market and was to be examined in the context of a consultation process. During these consultations, neither the national authorities nor the trade organisations argued in favour of changing the existing structure. Only one Member State considered that the range of between 5% and 55% for the specific component of excise duty should be widened.
- 1.3 Accordingly, the Commission does not consider it appropriate to propose amendments to the structure or rates of excise duty. It thus suggests only a few technical adjustments to existing legislation.

2. OPERATION OF THE SINGLE MARKET

- 2.1 The movement system for intra-Community transactions makes it possible to maintain in force a system whereby tax is levied by the Member State of destination, this being compatible with the abolition of border controls. On the whole, this system seems to work fairly well where lawful trade is concerned, despite the fact that substantial differences still exist in the rates of duty applied by Member States.
- 2.2 It is more difficult, on the other hand, to quantify the effect which the persistent disparity in rates could have on fraud in this sector. There is evidence that fraud has increased in the tobacco sector in recent years. There is also evidence to suggest that it is largely perpetrated by organised criminal gangs who are also involved in other criminal activities. These gangs operate wherever they can make the maximum profit at minimum risk to themselves, and the Community's tax systems have become a prime target. Their profits derive from the very high taxes levied on tobacco relative to its underlying value and, in some cases, from the fact that there are significant differences in rates of excise duty between Member States. Increasing rates of duty on tobacco would give such gangs an even greater incentive to introduce these products into fraud rings.
- 2.3 The significant differences in retail selling prices (which derive largely, but not exclusively, from the substantial differences in rates of duty between Member States) encourage people to buy the products concerned in Member States where duty is low and to transport them to Member States where duty is higher. As long as this is done by individuals for their own personal needs, the operation of the single market is not affected. When border crossings become more frequent and the quantities transported greatly exceed the purchasers' own needs, contraband causes serious competition problems.
- 2.4 In March 1996 a High-Level Group was set up to examine the nature and extent of fraud and the weaknesses of the systems and legislation in force, and to make

recommendations to the Directors-General of Indirect Taxation and Customs on how to combat fraud more effectively. This Group identified the following as the principal sources of fraud: failure to comply with legislation and to fulfil obligations, inadequate cooperation between Member States, lack of modern information technology and infrequent controls. Large-scale fraud is targeted mainly at the markets of Member States with the highest rates of excise duty. In addition, differences in rates of duty between Member States cause a growth in contraband involving duty-paid products. The Group has drawn up a list of recommendations to address the shortcomings discovered during their discussions. The Commission will work closely with the Member States to implement these recommendations and will make proposals if necessary. The principal recommendations concern the introduction of a computerised movement and control system for the Community excise system, the introduction of an excise early warning system for products liable to excise duty, improvements in the gathering and use of intelligence to increase the effectiveness of physical controls, the establishment of a code of best practice for licensing warehousekeepers and the negotiation of Memoranda of Understanding with producers and the trade.

- 2.5 Rates of duty thus provide an incentive to commit fraud. Even complete harmonisation of rates could not prevent the growth of illegal activities since harmonisation would necessarily mean aligning rates on the highest national rates within the Union.

A. Cigarettes

- 2.6 The rates of duty applied by Member States to cigarettes are shown in Annex B. The way in which the overall minimum rate of excise duty is expressed (as a percentage of the retail selling price) can give a misleading impression about the degree of approximation of rates of duty. The levels applied by Member States vary between 57% and 66.68% but, in absolute terms, the Member State levying the highest tax applies a rate four times higher than the Member State levying the lowest tax. Sweden, which is temporarily (until 31 December 1998) exempt from applying the 57% rule, is currently close to that rate. Despite the exemption, however, Sweden applies the fifth-highest rate of tax in absolute terms in the Community. This means that, even if every Member State were to set the overall minimum rate of excise duty at 57% of the retail selling price (or at any other standard percentage), the differences in taxation and in retail selling prices in absolute terms would persist. This is the result of the following factors: pre-tax prices, the most popular price category, the combination of the specific and *ad valorem* components, and VAT rates.
- 2.7 Despite these differences, no requests for greater convergence were made during the consultation process. In particular, the trade organisations saw no need for greater harmonisation of excise-duty rates. It was generally agreed, however, that the technical problems which had become evident when the existing rules were implemented would have to be resolved.
- 2.8 The retail selling price of cigarettes comprises several components, such as the ex works price, distributors' margins, excise duty (specific and *ad valorem*) and VAT. Since the incidence of overall minimum excise duty is calculated as a percentage of the final retail selling price for cigarettes in the most popular price category, it follows that a change in any one of these components would affect the ratio between the overall excise duty and the retail selling price.

- 2.9 This is very important in Member States where the level of excise duty is around or just above the minimum rate of 57%. An increase in the ex works price, for example, can cause the overall excise duty to fall below the 57% minimum, obliging the Member State concerned to raise its rate of excise duty in order to attain the 57% limit again.
- 2.10 Several Member States which levy high taxes on cigarettes are, however, at or just above the 57% threshold. The existing rules therefore have the perverse effect of forcing up excise duties in countries with already high tax burdens, which is clearly at odds with the overall commitment to approximate rates. In the long run, the differences in tax burdens (measured in money terms) in the Community could increase further, and this in turn would lead to greater tax-driven differences in retail selling prices. Such an effect would obviously not be in the interests of the single market.
- 2.11 This problem was raised in the first report on excise duties and was also examined during the consultation process. The problem arises where there is an increase either in a pre-tax price component (cost of labour, materials, etc.) or in VAT. Because of the nature of taxation on cigarettes, a pre-tax price increase of one unit results in a retail selling-price increase of more than one unit. There is, therefore, a multiplier effect. The greater the *ad valorem* tax, the higher the multiplier coefficient. Conversely, in Member States which apply mainly specific duty, the multiplier coefficients are lower. If only one specific excise duty is applied, any changes in the pre-tax price will affect only the rate of VAT.
- 2.12 The difficulties in applying the 57% rule are particularly severe when the level of taxation in a Member State is very close to 57% and the VAT rate is increased. This triggers a rise in the overall level of taxation which may not necessarily be what the Member State concerned wished.
- 2.13 The rate of excise duty comprises a component which is expressed as a percentage of the retail selling price of the goods, inclusive of VAT. In addition, VAT itself is applied to the value of the goods, inclusive of excise duty. Accordingly, a mere increase in the rate of VAT will lead to an increase in the burden of excise duty in absolute terms, which in turn will increase the base for calculating the new VAT rate. Furthermore, because of the change in the relative proportions of the different components of the retail selling price, overall excise duty will no longer amount to 57% of the retail selling price. It will, therefore, be necessary to introduce a further increase in excise duty which will in turn result in an increase in the base for calculating the new VAT rate, and so on. This process is known in the tobacco industry as the "cascade effect".
- 2.14 In no other sector is the impact of an increase in the rate of VAT so great. The industry argues that governments may pursue the tax policies of their choice but that they should not be forced to adjust their excise duties upwards without good reason and without having actually decided to do so.
- 2.15 A related question has emerged since the Lisbon Conference. It concerns the manner in which the 57% rule is applied in the Member States. This question was also raised at the meetings of the Excise Committee held in March and June 1996. It was noted at these meetings that Member States interpret the minimum incidence of 57% in two different ways.

- 2.16 Some Member States and the Commission departments thought it necessary to follow Article 2 of Directive 92/79/EEC to the letter. Checks on whether the minimum incidence of 57% has been attained are not limited to 1 January and need not be carried out only once a year. There is, on the other hand, a constant obligation to comply with the 57% minimum every time a change occurs in retail selling prices, while respecting the most popular price category, which is established only once a year. Other Member States disagreed with this interpretation and maintained that a check on the 57% minimum need be carried out only once a year. Some Member States agreed with the strict interpretation but said that they checked the incidence of excise duty only once a year.
- 2.17 In practice, it would seem that continuous checking is difficult to carry out and does not even constitute the best approach. Moreover, other interpretations exist which are equally valid but are not entirely consistent with a strict interpretation. It is, however, difficult to authorise indefinitely a situation in which there are different practices based on differing legal interpretations. A possible course of action would be to initiate infringement proceedings against Member States whose interpretation is not strictly correct. In so far as those Member States' interpretation is influenced by what they consider to be practicable, it might be preferable to make a technical amendment to Community legislation. The aim would be to authorise what is practised by the Member States and to grant some leeway to those Member States which have adhered to a strict interpretation of the law; the essential role of the existing rules would not, however, be called into question.
- 2.18 In addition, since the Lisbon Conference and as part of the consultation process, the two bodies representing the industry (CECCM and GITES) have held discussions to try and agree on a common approach to any amendment to the existing rules. There have also been many contacts with the Commission departments.
- 2.19 In order to incorporate this greater flexibility into Article 2 of Directive 92/79/EEC, the Commission concluded that, where a change occurred in the retail selling prices of cigarettes in the most popular price category or where VAT was increased, it was necessary to authorise Member States to refrain from adjusting the incidence of the overall minimum excise duty until 1 January at the latest of the second year following that in which the change took place.
- 2.20 In order to guarantee a consistent approach, similar flexibility would have to be granted in respect of adjustments to the specific component of excise duty. According to Article 16(2) of Directive 95/59/EC, specific excise duty on cigarettes may not be less than 5% or more than 55% of the amount of the total tax burden resulting from the aggregation of the proportional excise duty, the specific excise duty and the turnover tax levied on cigarettes in the most popular price category. The Commission concluded that it was necessary to amend Article 16 and to authorise Member States, in the event of excise duty falling below 5% or rising above 55% as a result of changes in the retail selling price of cigarettes in the most popular price category, to refrain from adjusting the incidence of the overall minimum excise duty until not later than 1 January of the second year following that in which the change took place.

B. Other manufactured tobacco

- 2.21 The rates of excise duty levied by Member States on cigars, cigarillos, hand-rolling tobacco and other smoking tobacco are given in Annex C. The first review of rates had shown that the taxation of cigars, cigarillos and other smoking tobacco did not give rise to any particular problems. Markets in these products show a significant drop in consumption.
- 2.22 However, where hand-rolling tobacco is concerned, the substantial differences in tax levels among Member States, combined with major differences in pre-tax prices, encourage smuggling between neighbouring countries. Large quantities of hand-rolling tobacco are purchased in Member States where taxation is lowest. These products are then resold illegally on the markets of Member States with a high tax rate (particularly the United Kingdom and Ireland). It would seem at first sight that it concerns a problem to be resolved by Member States who have to approximate their national rates and/or tighten up their control measures. On the other hand, an increase in minimum rates would be unacceptable to most Member States and to the tobacco industry, and would seriously upset the balance between the consumption of cigarettes and the consumption of hand-rolling tobacco.
- 2.23 The manner in which the rules for taxing cigars and hand-rolling tobacco are applied were the subject of a recent investigation. Directive 92/80/EEC stipulates that Member States must apply to cigars, cigarillos, hand-rolling tobacco and other smoking tobacco an excise duty that is either *ad valorem* or specific, or a mixture of the two. In addition, Member States may levy a minimum excise duty on hand-rolling tobacco (as on cigarettes), provided that this does not have the effect of raising the total tax to more than 90% of the total tax on the most popular price category of hand-rolling tobacco.
- 2.24 However, in at least one Member State, the rules have been interpreted as an authorisation to apply *ad valorem* rates to cigars and smoking tobacco, subject to fixed specific minimum levels. The Commission considers that this interpretation does not comply strictly with the Directive and has decided to initiate infringement proceedings.
- 2.25 Although there is an infringement at a technical level, the approach adopted by this Member State has no detrimental effects. There have been no complaints about this practice. A number of Member States consider that it may even have some merits and they would be interested in introducing similar measures to their own legislation if Community law so permitted. The effect of this measure is to increase the relative incidence of tax on the cheapest products. The European Cigar Manufacturers Association recently pointed out that the cheapest cigars do not compete with the most expensive. Competition actually comes from cigarette-style products which apparently comply with the definition of cigars and cigarillos, thereby benefiting from much lower tax levels. The cigar industry fears that, unless this development is stopped or at least kept in check, Member States will react by increasing overall levels of taxation, thereby penalising the traditional cigar industry.
- 2.26 The fact that the approach adopted by a Member State is illegal for cigars but quite legal for cigarettes and hand-rolling tobacco makes it more difficult to defend or justify the arrangements laid down by the Directive for cigars and smoking tobacco. The Commission, therefore, concluded that it was necessary to allow Member

States to levy a minimum excise duty on cigars and smoking tobacco too. Such a measure should not give rise to much opposition.

3. REAL VALUE OF EXCISE DUTY

3.1 The review must also cover the real value of excise duty. Account must, therefore, be taken of the actual rate adjustments made by Member States and to establish to what extent inflation is reflected in these adjustments. Normally, national authorities take account of inflation in drawing up their budget. It may be assumed that, in general, all other things being equal, these authorities raise excise duties in line with inflation.

A. Cigarettes

3.2 The minimum rate of excise duty on cigarettes is set at 57% of the retail selling price (inclusive of all taxes) of cigarettes in the most popular price category in each Member State, on the basis of data established at 1 January of each year. The fact that this minimum rate is expressed as a percentage of the retail selling price means that it automatically takes account of inflation and that no such adjustment is therefore needed.

B. Other manufactured tobacco

3.3 As indicated at point 3.2 of Chapter I, the minimum rates applicable to cigars, cigarillos, hand-rolling tobacco and other smoking tobacco are expressed both as a percentage of the retail selling price and as a specific amount. All other considerations aside, it should be noted that, over time and with rising inflation, there will be a gap between these two factors, with the *ad valorem* rate automatically tracking changes in retail selling prices.

3.4 Where actual rate movements are concerned, most Member States apply rates which rely mainly, if not exclusively, on an *ad valorem* component, ensuring that inflation is more or less automatically taken into account. Furthermore, Member States which apply specific taxation have tended to adjust their duty levels in this respect.

3.5 It is necessary to adjust in line with inflation minimum rates expressed as a specific amount in order to maintain the ratio fixed when the rates were first set. The Commission considers that it would be desirable at present to bring the specific minimum rates expressed in ecus into line with inflation.

3.6 Details of national consumer-price indices, as well as the average for the European Union, are given in Annex D. According to the consumer price indices drawn up by Eurostat, the rate of inflation was 4.1% in 1993, 3.2% in 1994, 3.0% in 1995, 2.6% in 1996 and 2.1% in 1997. For 1998 Eurostat forecasts a rate of 2.2%. The inflation rate for the period from 1992 (when minimum rates were set) to 1998 (when rates are to be reviewed) may therefore be estimated at some 18.5%. By applying this percentage to existing minimum rates and after rounding up to the nearest unit, the following minimum rates are arrived at:

- ECU 9 for cigars and cigarillos;
- ECU 24 for hand-rolling tobacco;

- ECU 18 for other smoking tobacco.

- 3.7 In its proposal amending Directive 92/80/EEC, the Commission will, therefore, suggest replacing the existing amounts with the above amounts from 1 January 1999.

4. WIDER OBJECTIVES OF THE TREATY

- 4.1 Given the criteria laid down for achieving economic and monetary union, it is essential that Community excise-duty policy, while aimed primarily at ensuring the smooth operation of the single market, should, on the one hand, guarantee sufficient revenue receipts and sound conditions at national level and, on the other, be consistent with the wider policies of the European Union. It is clear that reconciling the various Treaty objectives with improvements in the functioning of the single market raises potentially difficult issues which cannot always be easily resolved. Where manufactured tobacco products are concerned, particular attention must be paid to the health-protection aspects and to the relationship between such protection and the price of these products.
- 4.2 Every year hundreds of thousands of people in the European Union die of tobacco-related diseases. These diseases also add considerably to health-care costs. Taxation of tobacco products is an obvious means not only of discouraging tobacco consumption but also of funding the resulting health-care costs.
- 4.3 Tobacco is at present very heavily taxed in most Member States. This is justified on public-health grounds since it helps discourage consumption. High prices are particularly effective in discouraging young people from consuming tobacco since their resources are often limited. However, a policy of high tobacco taxes has limited effects for a number of reasons. In particular, such a policy does not affect smokers' dependence on nicotine. For it to have a preventive effect and act as a convincing disincentive, it should be accompanied by measures to help wean consumers off tobacco, to reduce tobacco advertising and to promote health-education and information campaigns.
- 4.4 During the consultation process, health-protection pressure groups argued in favour of higher tobacco taxes in general and of an approximation of rates on cigarettes and hand-rolling tobacco. They pointed out that hand-rolling tobacco is just as harmful as - or even more harmful than - cigarettes and that its low price makes it attractive to young people. Hand-rolling tobacco carries a particular health risk since cigarettes produced in this way do not contain standard doses, since there is not normally a filter and since no information is provided on tar levels and nicotine content. Moreover, lower taxation makes this product particularly attractive to young people. The arguments of the health-protection pressure groups are largely supported by the Commission. Their claims have though been disputed by the hand-rolling tobacco industry, represented by ESTA (European Smoking Tobacco Association), which emphasises that the product is consumed mainly by older smokers. This Association stresses that its industry is less automated than the cigarette industry and is, therefore, more labour-intensive. The lower tax rates compared with cigarettes are necessary in order to safeguard its survival. Lastly, it points out that its product has very limited market shares in relation to other tobacco-based products and that sales are concentrated for the most part in three Member States.

- 4.5 The public-health objective of reducing consumption through high taxation will fall short of its target if tobacco products evade this taxation. Moreover, if tobacco products avoid the normal marketing channels (with tax being paid in the Member State where it is actually due), they may also avoid other rules, such as those restricting sales to minors, those regarding tar levels and nicotine content, additives, labelling, etc. This factor must be taken into account when a tax increase is being considered. Consumers who do not have the financial resources to obtain tobacco legally but cannot do without it are tempted to obtain it on the black market. In some cases, these products, when sold illegally, do not offer the same quality and health guarantees because they are not subject to health controls. Illegal imports sold at prices below domestic prices may also encourage young people to smoke and influence their consumption habits. Such consumer behaviour, which is linked to fairly high taxation, therefore clearly has adverse effects on hygiene and health.
- 4.6 Maximum retail selling prices for different types of tobacco are freely set by manufacturers or, where appropriate, their representatives or agents within the Community and by importers releasing goods from third countries for home use in the individual Member States. Governments are free to set excise-duty levels nationally provided that they comply with the minimum levels laid down in Directives 92/79/EEC and 92/80/EEC. Subject to this proviso, therefore, it is largely up to the Member States to decide on the level of duty they apply and to take account of such factors as health and fraud.

5. FREQUENCY OF REVIEWS

- 5.1 Both Article 4 of Directive 92/79/EEC on the approximation of taxes on cigarettes and Article 4 of Directive 92/80/EEC on the approximation of taxes on manufactured tobacco other than cigarettes stipulate that the Council, acting on a proposal from the Commission, will examine the structure and rates of excise duty.
- 5.2 The Commission takes the view that a two-year period is too short to provide the proper perspective for assessing changes in Member States' legislation. A five-year period would be more appropriate for assessing the operation of the single market and the influences of any changes in legislation.
- 5.3 For that reason, the Commission has concluded that Article 4 of both Directives should be amended and that the review should take place every five years rather than every two years. It is, of course, free to make proposals before the end of this five-year period where it deems this to be necessary or where account needs to be taken of changes on the tobacco market. However, in order to take account of the need to raise the level of rates expressed as a specific amount, it intends to propose a two-stage increase in minimum rates.
- 5.4 The first stage, which involves adjusting the minimum rates applicable for the period 1992-98, is described at point 3.7 above. This increase should enter into force on 1 January 1999. The second stage is designed to take account of the rate of inflation for the period between 1 January 1999 and 31 December 2000. On the basis of Eurostat data, the rate of inflation can be put at around 2.2% a year or at 4.5% for the period as a whole. By applying this percentage to the minimum rates calculated above and after rounding up to the nearest unit, the following minimum rates are arrived at:

- ECU 10 for cigars and cigarillos;
- ECU 25 for hand-rolling tobacco;
- ECU 19 for other smoking tobacco.

The Commission will propose that these minimum rates enter into force on 1 January 2001.

- 5.5 The Commission will incorporate this timetable for raising the minimum rates for cigars, cigarillos, hand-rolling tobacco and other smoking tobacco into its proposal amending Directive 92/80/EEC.

IV. Conclusions

- 1.1 This review of the structure and rates of excise duty on tobacco leads to the conclusion that only a few technical amendments to existing Community legislation are necessary. The technical amendments envisaged have been agreed upon by the entire tobacco industry unlike in the past, when bodies representing multinationals and monopolies have traditionally held opposing views. After consulting the trade organisations and bearing in mind that the previous review was fairly recent, the Commission concluded that the structures and rates of excise duty could remain unchanged.
- 1.2 Where cigarettes are concerned, the Commission concluded that Member States should be given greater leeway for adjusting the incidence of the overall minimum duty in the event of a change either in the retail selling price of cigarettes in the most popular price category or in value added tax. Similar leeway should be granted for adjustments to the specific component of excise duty when this component is expressed as a percentage of the retail selling price.
- 1.3 The Commission concluded that Article 16 of Directive 95/59/EC should be amended in order to enable Member States to levy a minimum excise duty on cigars, cigarillos and smoking tobacco.
- 1.4 The specific minimum amounts for tobacco other than cigarettes should be brought into line with inflation.
- 1.5 It would appear more appropriate to review the structure and rates of excise duty at five-yearly rather than two-yearly intervals.

V. ANNEXES

List of annexes

Annex A : Revenue from excise duty on manufactured tobacco as a percentage of gross domestic product

Annex B : Current rates for cigarettes in the Member States

Annex C : Current rates for manufactured tobacco other than cigarettes in the Member States

- Annex C.1 : cigars and cigarillos
- Annex C.2 : hand-rolling tobacco
- Annex C.3 : other smoking tobacco

Annex D : Annual change in consumer prices between 1992 and 1998

Annex A

REVENUE FROM EXCISE DUTY ON MANUFACTURED TOBACCO AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT (1996)

	<i>Revenue from excise duty (ECU million)</i>	<i>GDP (ECU billion)</i>	<i>Excise revenue (% of GDP)</i>
<i>Belgium</i>	1 088.76	211.3	0.52%
<i>Denmark</i>	993.16	137.80	0.72%
<i>Germany</i>	10 757.60	1 854.60	0.58%
<i>Greece</i>	1330.66	96.50	1.38%
<i>Spain</i>	2759.02	457.80	0.60%
<i>France</i>	6259.57	1 210.60	0.52%
<i>Ireland</i>	643.99	55.7	1.16%
<i>Italy</i>	5031.99	956.40	0.53%
<i>Luxembourg</i>	212.63	13.50	1.58%
<i>Netherlands</i>	1 398.81	312.00	0.45%
<i>Austria</i>	929.64	180.30	0.52%
<i>Portugal</i>	842.13	81.70	1.03%
<i>Finland</i>	521.49	98.60	0.53%
<i>Sweden</i>	776.10	197.10	0.39%
<i>United Kingdom</i>	8 798.59	908.40	0.97%

Cigarettes

Manufactured tobacco

Situation as at 1.6.97

		Cigarettes											
		Specific excise duty (1000 items)				<i>Ad valorem</i> excise duty	% VAT	<i>Ad valorem</i> excise duty + VAT	Total specific tax + Ad.Val + VAT	Current price of 1000 cigarettes in the most popular price category.		Total tax burden	Overall minimum excise duty
RPIAT= retail selling price incl. all taxes	Nat. currency	ecu	(as % of retail selling price)	(as a % of aggregate specific and <i>ad valorem</i> tax + VAT)	(as % of retail selling price)	(as % of retail selling price)	(as % of retail selling price)	(as % of retail selling price)	(as % of retail selling price)	National currency	in ecus	(ecus per 1000 cigarettes)	specific excise duty + <i>ad valorem</i> excise duty, exclusive of VAT
			(RPIAT)	(RPIAT)	(RPIAT)	(RPIAT)	(RPIAT)	(RPIAT)	(RPIAT)				
Minimum rate of excise duty adopted by the Council on 19.10. 92													57% of retail selling price (incl. all taxes)
MS	Nat. curr.												
AT	OS	246.00	18.22	15.38%	20.77%	42.00%	16.67%	58.67%	74.04%	1600.00	118.53	87.76	57.38%
BE	BFR	357.00	9.04	6.97%	9.38%	50.00%	17.36%	67.36%	74.33%	5120.00	129.61	96.33	56.97%
DE	DM	83.00	43.25	32.52%	46.21%	24.80%	13.04%	37.84%	70.36%	255.26	133.02	93.59	57.32%
DK	DKR	606.80	82.40	41.14%	49.95%	21.22%	20.00%	41.22%	82.36%	1475.00	200.29	164.96	62.36%
EL	DRA	1000.31	3.30	3.64%	5.00%	53.86%	15.25%	69.11%	72.75%	27500	90.70	65.99	57.50%
ES	PTA	500.00	3.09	5.88%	7.98%	54.00%	13.79%	67.79%	73.68%	8500	52.61	38.76	59.88%
FI	FMK	90.00	15.67	8.37%	10.96%	50.00%	18.03%	68.03%	76.40%	1075.00	187.19	143.02	58.37%
FR	FF	36.67	5.65	3.80%	5.04%	54.50%	17.08%	71.58%	75.38%	965.00	148.60	112.01	58.30%
GB	UKL	65.97	81.98	42.84%	54.41%	21.00%	14.89%	35.89%	78.73%	154.00	191.38	150.67	63.84%
IE	IRL	62.64	79.74	42.47%	55.33%	16.93%	17.36%	34.29%	76.75%	147.50	187.78	144.12	59.40%
IT	LIT	6384.56	3.33	3.65%	5.00%	53.35%	15.97%	69.32%	72.96%	175000	91.35	66.66	57.00%
LU	LFR	127.00	3.21	3.45%	5.03%	54.50%	10.71%	65.21%	68.67%	3680	93.15	63.96	57.95%
NL	HFL	82.70	38.43	35.96%	50.02%	21.04%	14.89%	35.93%	71.89%	230.00	106.87	76.83	57.00%
PT	ESC	1452.00	7.44	9.68%	11.61%	57.00%	16.67%	73.67%	83.35%	15000.00	76.87	64.07	66.68%
SE	SKR	660.00	79.10	36.16%	49.84%	16.40%	20.00%	36.40%	72.56%	1825.00	218.72	158.72	52.56%

PT: A reduced rate of up to 50% less may be applied to cigarettes consumed in the most remote regions of the Azores and Madeira and made by small-scale manufacturers each of whose yearly output does not exceed 500 tonnes (Directive 92/79/EEC, Art.3(2)).

Cigars and cigarillos

Manufactured tobacco

Situation on 1.6.97

		Cigars and cigarillos					
		Specific excise duty		<i>Ad valorem</i> excise duty	% VAT	<i>Ad valorem</i> excise duty + VAT	Overall minimum excise duty expressed as % or as an amount per kilogram or per 1000 items
		Nat. currency	ecu	(as % of retail selling price) (RPIAT)	(as % of retail selling price) (RPIAT)	(as % of retail selling price) (RPIAT)	5% of retail selling price, incl. All taxes ECU 7 per 1000 items or per kilogram (Art. 3 of Directive 92/80)
RPIAT = retail selling price incl. All taxes		Minimum rate of excise duty adopted by the Council on 19.10.92					
MS	Nat. currency						
AT	OS	0.00	0.00	13.00%	16.67%	29.67%	
BE	BFR	0.00	0.00	10.00%	17.36%	27.36%	
DE	DM	0.00	0.00	5.00%	13.04%	18.04%	
DK	DKR	198.00	26.89	10.00%	20.00%	30.00%	
EL	DRA	0.00	0.00	26.00%	15.25%	41.25%	
ES	PTA	0.00	0.00	12.50%	13.79%	26.29%	
FI	FMK	0.00	0.00	22.00%	18.03%	40.03%	
FR	FF	0.00	0.00	28.86%	17.08%	45.94%	
GB	UKL	98.02	121.81	0.00%	14.89%	14.89%	
IE	IRL	94.65	120.50	0.00%	17.36%	17.36%	
IT	LIT	0.00	0.00	23.00%	15.97%	38.97%	
IT	LIT	0.00	0.00	46.00%	15.97%	61.97%	
LU	LFR	0.00	0.00	10.00%	10.71%	20.71%	
NL	HFL	0.00	0.00	5.00%	14.89%	19.89%	
PT	ESC	0.00	0.00	26.21%	16.67%	42.88%	
SE	SKR	440.00	52.73	0.00%	20.00%	20.00%	

General remark: The rates or amounts are effective for all products belonging to the group of manufactured tobaccos concerned, without distinction within each group as to quality, presentation, origin of the products, the materials used, the characteristics of the firms involved or any other criterion (Directive 92/80/EEC, Article 3(2)).

ES and IT: These two countries may, until 31 December 1998, apply to rolls of tobacco consisting entirely of natural tobacco which are not cigarettes a rate or amount which may be up to 50% less than the normal national rate of excise duty for cigars and cigarillos and which may fall below the minimum rate (Directive 92/80/EEC, Article 3(3)).

Fine-cut smoking tobacco intended for the rolling of cigarettes

Manufactured tobacco

Situation as at 1.6.97

RPIAT= retail selling price incl. all taxes		Fine-cut smoking tobacco intended for the rolling of cigarettes					Overall minimum excise duty expressed as % or as an amount per kilogram
		Specific excise duty		<i>Ad valorem</i> excise duty	% VAT	<i>Ad valorem</i> excise duty + VAT	
Minimum excise duty rate adopted by the Council on 19.10.92		Nat. currency	ecu	(as % of retail selling price) (RPIAT)	(as % of retail selling price) (RPIAT)	(as % of retail selling price) (RPIAT)	30% of retail selling price, incl. all taxes ECU 20 per kilogram (Art. 3 of Directive 92/80)
MS	Nat. currency						
AT	OS	0.00	0.00	47.00%	16.67%	63.67%	
BE	BFR	0.00	0.00	37.55%	17.36%	54.91%	
DE	DM	30.21	15.74	18.12%	13.04%	31.16%	
DK	DKR	400.00	54.32	0.00%	20.00%	20.00%	
EL	DRA	0.00	0.00	59.00%	15.25%	74.25%	
ES	PTA	0.00	0.00	37.50%	13.79%	51.29%	
FI	FMK	12.00	2.09	48.00%	18.03%	66.03%	
FR	FF	0.00	0.00	51.00%	17.08%	68.08%	
GB	UKL	87.74	109.03	0.00%	14.89%	14.89%	
IE	IRL	79.87	101.68	0.00%	17.36%	17.36%	
IT	LIT	0.00	0.00	54.00%	15.97%	69.97%	
LU	LFR	0.00	0.00	31.50%	10.71%	42.21%	
NL	HFL	36.10	16.77	15.72%	14.89%	30.61%	
PT	ESC	0.00	0.00	30.00%	16.67%	46.67%	
SE	SKR	394.00	47.22	0.00%	20.00%	20.00%	

General remark: The rates or amounts are effective for all products belonging to the group of manufactured tobaccos concerned, without distinction within each group as to quality, presentation, origin of the products, the materials used, the characteristics of the firms involved or any other criterion (Directive 92/80/EEC, Article 3(2)).

Other smoking tobacco

Manufactured tobacco

Situation as at 1.6.97

		Other smoking tobacco					
		Specific excise duty rate		<i>Ad valorem</i> excise duty	% VAT	<i>Ad valorem</i> excise duty + VAT	Overall minimum excise duty expressed as % or as an amount per kilogram
		National currency	ecu	(as a % of retail selling price) (RPIAT)	(as a % of retail selling price) (RPIAT)	(as a % of retail selling price) (RPIAT)	20% of retail selling price, incl. all taxes ECU 15 per kilogram (Art. 3 of Directive 92/80)
Minimum rate of excise duty adopted by the Council on 19.10.92							
MS	Nat. currency						
AT	OS	0.00	0.00	34.00%	16.67%	50.67%	
BE	BFR	0.00	0.00	37.55%	17.36%	54.91%	
DE	DM	5.50	2.87	22.00%	13.04%	35.04%	
DK	DKR	350.00	47.53	20.00%			
EL	DRA	0.00	0.00	59.00%	15.25%	74.25%	
ES	PTA	0.00	0.00	22.50%	13.79%	36.29%	
FI	FMK	12.00	2.09	48.00%	18.03%	66.03%	
FR	FF	0.00	0.00	46.74%	17.08%	63.82%	
GB	UKL	43.10	53.56	0.00%	14.89%	14.89%	
IE	IRL	65.67	83.60	0.00%	17.36%	17.36%	
IT	LIT	0.00	0.00	54.00%	15.97%	69.97%	
LU	LFR	0.00	0.00	31.50%	10.71%	42.21%	
NL	HFL	36.10	16.77	15.72%	14.89%	30.61%	
PT	ESC	0.00	0.00	30.00%	16.67%	46.67%	
SE	SKR	75.00	8.99	0.00%	20.00%	20.00%	
SE	SKR	489.00	58.61	0.00%	20.00%	20.00%	

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ANNUAL CHANGE IN CONSUMER PRICES BETWEEN 1992 AND 1998

	1998	1997	1996	1995	1994	1993	1992
<i>Belgium</i>	1.8	1.7	2.3	1.7	2.8	3.5	2.3
<i>Denmark</i>	2.5	2.1	2.1	2.0	1.6	0.6	2.0
<i>Germany</i>	2.2	2.1	1.9	1.9	2.8	4.0	4.9
<i>Greece</i>	4.5	6.0	8.5	9.3	10.8	13.8	15.0
<i>Spain</i>	2.2	2.1	3.4	4.7	4.8	5.6	6.4
<i>France</i>	1.5	1.3	1.9	1.6	2.1	2.2	2.4
<i>Ireland</i>	2.5	1.4	1.1	2.0	2.7	1.9	2.6
<i>Italy</i>	2.2	2.2	4.3	5.8	4.6	5.4	5.6
<i>Luxembourg</i>	1.7	1.6	1.4	0.7	2.3	4.1	3.4
<i>Netherlands</i>	2.4	2.1	1.3	1.5	2.8	2.1	3.1
<i>Austria</i>	2.1	1.9	2.5	1.5	3.3	3.3	3.9
<i>Portugal</i>	2.1	2.2	3.3	4.2	5.1	6.6	9.1
<i>Finland</i>	2.0	1.3	1.6	0.3	1.4	4.2	4.1
<i>Sweden</i>	2.0	1.8	1.2	2.4	3.0	5.7	2.2
<i>United Kingdom</i>	2.4	2.4	2.6	2.6	2.2	3.4	5.0
<i>Total (all Member States)</i>	2.2	2.1	2.6	3.0	3.2	4.1	4.7

Source : Eurostat