

Fiscal deaths ahead: European Commission wants to tax e-cigarettes



EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Indirect Taxation and Tax administration
Indirect taxes other than VAT

Brussels 3.2.2015
taxud.c.2(2015) 490338 AB/at

FISCALIS PROJECT GROUP

ON THE CLASSIFICATION AND INCLUSION OF (NEW) PRODUCTS IN THE
SCOPE OF EXCISABLE TOBACCO PRODUCTS

AGENDA

MEETING OF 18TH FEBRUARY 2015 – ROOM 0C ALBERT BORSCHETTE,
BRUSSELS

Tumescent tax officials have found something new to tax

What if basic economics tells you that raising a tax on a newer, much safer, product will lead to more consumption of an older much more dangerous product than there would otherwise be? What if the consequence of that tax was to cause more cancer, heart disease and emphysema, and to cause more people to die prematurely? Would you raise that tax? Would you knowingly cause 'fiscal deaths'?

The European Commission seems intent on doing exactly that. The Financial Times ([European Commission considers taxing e-cigarettes](#)) reports on a meeting that happened yesterday 18th February 2015. The meeting agenda document has emerged ([PDF](#)) and has set off alarm bells. This is for a meeting of the [Fiscalis Project](#) in which officials from the Commission and EU member states gather to talk about the future of EU taxes. The agenda is troubling in several respects: the loaded questions put to attendees at the meeting; the narrow mis-framing of the issues built into the questions; and the barely disguised policy biases of the Commission officials who drew this up. It is not a neutral open-minded inquiry. It is a first step in imposing taxes on a category of vastly safer alternatives to smoking.

Questions raised by the European Commission

The agenda poses six questions for discussion at the meeting. Here they are with what I think are appropriate answers.

(a) Do you experience problems in your Member State because E-cigarettes and other (new) nicotine containing products are currently not excisable products? (E.g. in terms of decrease of revenue, distortion of competition, lack of regulation, health issues etc.)

Appropriate answer. No, these are not problems, and we should be glad to have them. We lose revenue when people quit smoking or use pharmaceuticals to quit.

But reducing smoking and related non-communicable disease is the broader policy aim of governments and European institutions. Governments are trying to prevent death and disease before it happens to save money in the healthcare system, to improve productivity and to help people live longer happier lives (see [NHS](#) for example). We normally justify cigarette taxes as an incentive to quit smoking. We would be absurdly cynical if we tried to replace revenue lost when people respond to this incentive by taxing a new category of product that allows people respond to the incentive. There are no distortions of competition because in the most important respect, namely the harm to health, these new products pose 95-99% lower risk than cigarettes. They are completely different so should be taxed differently. The 'health issues' are all positive but would become negative if we raised taxation and so encouraged smoking by adversely changing the relative costs of smoking and vaping to consumers.

(b) What are your impressions of the development and size of the market of E-cigarettes and other (new) nicotine containing products? Are there any signs of substitution of the regular tobacco products?

Appropriate answer. E-cigarette and vapour product sales have been growing rapidly and displacing cigarettes and converting smokers to vaping, increasing quit attempts and improving health. All of this is encouraging, not a cause for concern or for new taxes. However, growth has stalled as hundreds of misleading press stories originating from ideologically motivated health bodies, including the European Commission, have sought to undermine these innovative products and the concept of tobacco harm reduction. The European Union led by

DG SANCO has passed an obtuse directive of unscientific, unlawful and arbitrary measures that will do nothing for health, but will slow down the growth of this new rival to cigarettes.

(c) What do you think of the option to adjust the scope of excisable products by including a nicotine-based category? Please elaborate if you think there are more attractive options. (Multiple answers possible and appreciated!)

Appropriate answer. It does not need multiple answers. The simple single answer is that it is an extremely poor idea. These low risk recreational nicotine products should be taxed in the same way as coffee – i.e. as a consumer good, with VAT charged at the standard rate of 20% (UK), *and no more*. In fact a more appropriate tax comparator is the *reduced* rate of VAT charged on pharmaceuticals (NRT sold over the counter attracts [a reduced VAT rate of 5% in the UK](#) – this tax treatment is [different in each country](#)). The analysis should start with the question: what is our rationale for raising specific taxes on products like tobacco or alcohol?

(d) What would be in your opinion the best way to achieve fiscal equal treatment between the new category and existing categories?

Appropriate answer. If the question means *equalising taxation* between the new category and existing, for example by working out what liquid or e-cigarette consumption equates to a 20 per day smoking habit and then equating the burden of taxation, then the question contains a false premise. This is because e-cigarettes and cigarettes are not comparable and should be treated differently, under the principle of non-discrimination:

...the principle of equal treatment or non-discrimination requires that comparable situations must not be treated differently and that different situations must not be treated in the same way unless such treatment is objectively justified ([Case 304/01 Sept 2004 Spain v European Commission](#) para 31).

If the justification for taxing tobacco at much higher rates than other consumer goods such as coffee is the high level of harm caused to users and others, then these new products should be taxed in proportion to the risks they cause. In the

case of e-cigarettes this is likely to be about 95-99% lower than cigarettes. Or perhaps they should be *negatively* taxed because of the net *health benefits* they create when people switch from smoking to vaping.

(e) What could be a way to monitor and control the new category of excisable products (think about IT tools, laboratory testing, markers etc.)?

Appropriate answer. This question is premature and should follow deeper consideration of the issues of principle. However, the immense bureaucratic burdens of the Tobacco Products Directive ([2014/40/EU](#)) will provide more than enough data to satisfy the most pedantic tax inspector. Officials need to understand the category better and take a wider view of policy objectives, not get to work on the details of how to levy a tax well before any agreement in principle to proceed. In fact, these innovative disruptive products need the benefits of free movement of goods in a frictionless internal market, not a system of bonded warehouses and weights and measures officials charging taxes. Please read this [Summary for Policymakers on science and policy aspects of e-cigarettes and vaping](#) before having any further discussions.

(f) Identify weak points or problematic issues related to the new category (e.g. easy to circumvent by development of new products, lack of monitoring and control, internet sales, import/export from/to third countries etc.)

Appropriate answer. The main weak point is the one-sided nature of the framing of these questions and their discordance with the reality of what these products are, how they are used and why. The main weak point in European Union policy is to treat these products as though they are a problem rather than an opportunity, both through arbitrary and disproportionate regulation, and now through suggestions of counterproductive taxation. The agenda for the meeting reflects the Commission's tendency to competence creep; the habitual failure of meetings like this ever to say "*no, we really shouldn't intervene*"; the reactionary and anti-innovation culture of the EU; the poor scientific understanding increasingly underpinning EU policy; and an insular and narrow approach to policy making that serves no-one well.

Questions not asked by the European Commission

Not only were the questions posed highly loaded, but the questions not asked were also revealing. Here are some:

- Is there a justification for EU harmonising action in this area under the treaties (TFEU article 113)?
- What is the rationale for taxing tobacco at a higher level than other consumer products, and to what extent does this rationale apply to e-cigarettes and vapour products?
- What is the underlying model of nicotine using behaviour without which we will be unable to assess impacts, and what are the [cross elasticities](#) between these products and tobacco products?
- How many 'fiscal deaths' and additional cases of serious diseases would be caused in the European Union if 'tax treatment was equalised'? What trade offs should we make between increased fatal disease and gathering more tax revenue?
- What are the likely knock on costs to the health care system?
- How many small and medium enterprises would fail?
- How can we diversify tax revenue to cope with any decline in tobacco taxes in a way that minimises welfare loss, rather than just finding something similar-looking and taxing that even though it is very different?
- Given liquids are easily concealed and traded across borders or informally, would enforcement costs exceed revenues? What size of black market or DIY market would we be willing to tolerate?
- How do we reconcile the wildly different tax treatment applied to different ways to stop smoking, for example 5% VAT on NRT and no VAT on prescription stop smoking medicines?

FOI request for background presentation

I have made a freedom of information request for the introductory presentation made by the Commission ([agenda item 4](#)) and will share it here when it arrives, no later than 12 March 2015 (15 working days from submission on 19th February). See [FOI request at Ask the EU](#).

European Union tobacco tax policy - how it works

Process for agreeing EU tax legislation. The European Commission does not, in isolation, determine excise duties on tobacco and cannot unilaterally impose a tax on e-cigarettes, personal vaporisers or e-liquids. As with all significant EU legislation it has to be agreed by the Member States – for tax policy the Council is the sole legislator. In the case of taxation at EU level, it has to be agreed under a [Special Legislative Procedure](#) by unanimity, so each Member State has a veto. See [overview of tax legislation in the EU](#). Unlike the Tobacco Products Directive, which was agreed under the Ordinary Legislative Procedure, for legislation on taxation, the European Parliament just gives an opinion and cannot vote it down or amend proposals.

Form of EU tobacco excise duty legislation. The EU sets a [legal framework for excise duties on tobacco](#) with authority drawn from [Article 113 of the Treaty on Functioning of the European Union](#). The current primary legal instrument is [Directive 2011/64/EU](#). This directive does not set actual duty rates, but prescribes the type of duties, range of rates and other constraints than must be applied by Member States in setting tobacco duties in national legislation. So in practice there is an EU framework agreed by unanimity that allows Member States considerable discretion in the structure and level of tobacco taxation. Three types of duties apply: specific duty (a fixed amount per 1000 cigarettes, currently £184.10); *ad valorem* duty (a fixed percentage of the final selling price, currently 16.5%); Value Added Tax, currently 20%.



Structure of taxes on 20 cigarettes based on duty and tax rates from HMRC at Feb 2015 – 82% of the retail price is tax

Why does the Commission's posture in this meeting matter?

Although the Commission does not decide, it has *power to initiate legislation* and what it intends and proposes becomes the default focal point of negotiations between Member States. We saw this with the Tobacco Products Directive, much of which is little changed from the proposal the Commission made in December 2012. We also know from the Tobacco Products Directive that member states tend to prize a poor agreement over no agreement, so although they may have vetoes Member States will often be reluctant to use them, even if they don't like what's on the table. These 'collective action' effects mean that the Commission has more power and influence than it appears to have on paper.