

HEATED TOBACCO AS A NOVELTY TOBACCO PRODUCT SUBJECT TO EXCISE DUTY: A CROSS-COUNTRY COMPARISON

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Abstract. First prototypes of tobacco heaters were developed by the largest global tobacco companies as early as the 1980s. However, the first heat-not-burn tobacco products (not resembling the prototypes) were promoted on the market with success many years later – in 2014 in Japan, then in Switzerland, and in Italy. From the beginning, these products were offered for sale with the information that they were less risky for consumers, compared to traditional tobacco products. The first definition of novel tobacco products, which included heated tobacco products (HTPs), was part of the so-called Tobacco Directive (TPD). However, HTPs are not yet a subject to TPD norms. Therefore, each Member State is free to apply the excise tax rates to HTPs. Currently, there is a discussion in the EU on harmonizing excise tax policy also with regard to heated tobacco. The article discusses the current legal status of HTPs at the level of EU law, as well as in light of legal systems of selected Member States representing a diversified approach in the field of excise policy towards this category of tobacco products.

Keywords: excise tax; heated tobacco products; novel tobacco products; health consequences; the fiscal impact of the excise tax on HTPs

INTRODUCTION

Heated tobacco products (HTPs) are a new type of product created by tobacco companies to substitute traditional tobacco products. These products differ from traditional cigarettes. Instead of regular tobacco, they use tobacco-containing elements, also generally referred to as units or refills (these are usually *sticks* that look like cigarettes, wrapped in special paper) which are heated using dedicated, stylish, and modern-looking, electronic devices [Gruszczynski and Melillo 2020, 1]. The latter are embedded with heating systems to heat the tobacco rapidly (the whole process takes several seconds, from about 15 to 20 seconds). Thus, the tobacco contained in the cartridges is not burned in the device. Heating, in this case, is the process of bringing

the temperature to approximately 250-350°C depending on the type of device induction or smokeless [Auer, Concha-Lozano, Jacot-Sadowski, et al. 2017, 1050-1052; Davis, Williams, and Talbot 2019, 34-41]. In contrast, to smoke a cigarette, tobacco needs to reach approximately 600-800°C.¹ For HTPs, a pack of refills typically contains 20 units, with a price equal to or slightly higher than that of a high-quality cigarette pack. However, there is a difference between HTPs and e-cigarettes – the former use tobacco, whereas the latter use liquids. A liquid containing nicotine is heated and then inhaled.

The leading manufacturers claim that HTPs are less damaging (they are the so-called *reduced risk* products) to health than traditional tobacco products. Due to that, the vast majority of countries that allow these products to be marketed put a lower (and thus preferential) excise tax rate on HTPs than on cigarettes, thereby promoting these products and making them more competitive. According to research, on average, excise tax on a pack of traditional cigarettes worldwide comprises 56% of its retail price. In comparison, on average, excise tax on HTP refills comprises 18% of its retail price.² For EU countries, the current average excise rate on HTPs is about 30% of that on traditional cigarettes and this percentage is bound to increase.³ The following matter remains open: how will future harmonization efforts renegotiate this rate?

However, there is a lot of controversy surrounding the health consequences of HTPs. The World Health Organization (WHO) is strongly opposed to the preferential tax treatment of these products. WHO refers to HTPs as *pecially designed cigarettes* and calls for them to be subject to the same regulations as traditional cigarettes in order to reduce their use. This includes high excise taxes. WHO estimates that heated products contain about 20 substances of potential health concern (in particular, carcinogens).⁴

The aim of the current article is a synthetic analysis of selected legal systems of European countries in the context of excise duty policy related to HTPs. This is important in the context of the European Commission's announced harmonization of legislation in this area.⁵ Nonetheless, it is almost

¹ *Statement on the toxicological evaluation of novel heat-not-burn tobacco products*, opinion from the UK Committee on Toxicity, p. 2, point 6, www.cot.food.gov.uk/sites/default/files/heat_not_burn_tobacco_statement.pdf [accessed: 08.08.2021].

² *WHO report on the global tobacco epidemic 2021. Addressing new and emerging products*, report produced by the World Health Organization, 2021, www.who.int/teams/health-promotion/tobacco-control/global-tobacco-report-2021 [accessed: 02.08.2021].

³ *European Commission expected to revise tobacco directive*, www.vaporproductstax.com/european-commission-expected-to-revise-tobacco-excise-directive/ [accessed: 05.08.2021].

⁴ *Heated tobacco products (HTPs). Information sheet*, World Health Organization, ed. 2, 2020, www.who.int/publications/i/item/WHO-HEP-HPR-2020.2 [accessed: 05.08.2021].

⁵ *Commission staff working document evaluation of the Council Directive 2011/64/EU*

certain that this process will not be completed by 2024, so the issue of excise duty rates on HTPs will continue to be the subject of legislative efforts in individual Member States for a number of years to come.

1. DEVELOPMENT OF HTP MARKET TO DATE

The development of the first HTPs by major global tobacco companies began as early as the 1980s [Gruszczynski and Melillo 2020, 1]. However, the first successful HTPs (which were nothing like their prototypes) were released in 2014 in Japan by Philip Morris International (in Japan, e-cigarettes are not available, and the domestic market for heated tobacco is the most diverse in the world). In Europe, the first devices of this type were launched in Italy and Switzerland in 2014, by the same tobacco company [McNeil, Brose, Calder, et al. 2018, 201]. From the beginning, these products have been offered for sale (also through fairly aggressive direct sales) with the message that they pose far less risk to consumers than traditional tobacco products. The success on the European and Asian markets can be attributed to HTPs' potentially lower harmfulness. Moreover, the *aspirational brand* aspect and contemporary fashion trends also contributed to the increased popularity, especially among younger consumers aged between 15 and 24.⁶ Across this group in Europe in 2020, 7% of consumers declared using HTPs at least occasionally, while 2% declared regular use.⁷

2. THE EVOLUTION OF EXCISE DUTY AND THE CURRENT STATE OF THE LAW IN THE EU

The tobacco industry is a large sector of the economy which significantly contributes to job creation and budget revenues from tobacco excise duties.

of 21 June 2011 on the structure and rate of excise duty applied to manufactured tobacco, euroconsulting.be/wp-content/uploads/2020/02/10-02-2020-tobacco-taxation-report.pdf [accessed: 05.08.2021].

⁶ There is a clear downward trend in the use of traditional tobacco products among adolescents – see, for example, Summary results of the global youth tobacco survey in selected countries of the WHO European region, World Health Organization Report 2020, p. 7. Poland, in particular, ranks quite high among European countries where smokeless tobacco products are particularly popular among consumers in the 13-15 age group, WHO Report, p. 9, www.euro.who.int/en/health-topics/disease-prevention/tobacco/publications/2020/summary-results-of-the-global-youth-tobacco-survey-in-selected-countries-of-the-who-european-region-2020 [accessed: 20.08.2021].

⁷ Report of 5 May 2021 from the Commission to the European Parliament and the Council on the application of Directive 2014/40/EU concerning the manufacture, presentation and sale of tobacco and related products, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0249&from=EN> [accessed: 20.08.2021], p. 11.

In general, there is a wide variation in excise revenues across EU countries as a result of differences in population sizes within Member States, demand for excise goods, and different excise duty rates [Rosiński 2015, 168]. Countries with lower GDP tend to rely more on excise revenues than those with higher GDP. A considerably broader scope of goods is subject to excise duty in the former group of countries.

State tax policy focuses on the three primary objectives: 1) fiscal; 2) economic – development or inhibition of development of certain sectors of the economy; 3) social – involving, for instance, education or health care [Pomaskow 2017, 136].

Excise duties are imposed on goods for which demand is inflexible or relatively inflexible. Moreover, the production, distribution, and sale of these goods are thoroughly and effectively controlled by the state. Lastly, excise duties are imposed on products which are harmful (to health or environment) or considered luxury.⁸

In economics, optimal taxation is explained by the Laffer curve [Nowak-Far 2021, 101]. It is extremely difficult to determine the tipping point on the curve beyond which excise revenues drop. It can only be estimated through systematic, albeit modest, increases in excise rates to assess the flexibility of demand and other factors that influence sales of a particular product (e.g., the number of cigarettes smoked on average per day, and black-market share of tobacco products).

The amount of excise duty revenue and the economic impact of excise duty depend on their structure. As a general rule, there are two main ways of calculating excise duty on excisable goods: *ad valorem* and *ad quantum* (also referred to as *specific*). In some countries excise duty may be collected on the basis of a hybrid method, namely, on the quantity of goods and the percentage of the maximum price (this applies in particular to tobacco or alcohol products). The literature considers it optimal to structure tobacco excise duty based on a hybrid method, where either the *ad valorem* rate or *ad quantum* rate may dominate. Alternatively, a specific product value threshold can be set, below which the *ad quantum* tax is applicable. Above that threshold, the *ad valorem* tax is applicable, or a mixed rate of *ad quantum* and *ad valorem* tax. In the EU, regarding excise duty on HTP, the *ad valorem* rates are implemented in most countries.⁹

⁸ *Selected Excise Duties in OECD Countries. Consumption Tax Trends 2020: VAT/GST and Excise Rates, Trends and Policy Issues*, OECD, iLibrary (oecd-ilibrary.org) [accessed: 02.08.2021].

⁹ *European Commission expected to revise [...]*.

3. EXCISE DUTY REGULATIONS ON HTPS IN INDIVIDUAL EU MEMBER STATES

The concept of novelty products was first legally defined in EU law, in the so-called Tobacco Products Directive (TPD), that is Directive 2014/40 EU Parliament and Council of 3 April 2014.¹⁰ According to Article 2(14) of the TPD, novelty products are tobacco products which are not any of the following: cigarettes, roll-your-own tobacco, pipe tobacco, water-pipe tobacco, cigars, cigarillos, chewing tobacco, nasal tobacco, or tobacco for oral use, placed on the market after 19 May 2014. This is a negative definition, characterized by the absence rather than the presence.

Novelty products, however, are not covered by the EU's Tobacco Tax Directive, which greatly limits the freedom of Member States to set excise rates on tobacco products. In turn, this currently results in significant tax differences between EU countries.

There are four main legal situations regarding HTPs: 1) ban on import and sale of HTPs, for example in Norway,¹¹ Australia, or Mexico; 2) permitted import and sale, with standard tobacco regulations applicable; 3) permitted import and sale, application of preferential excise duty rates. There is a whole range of ideas regarding the degree of this preferentiality; there are cases of temporary suspension of excise duty collection in order to encourage consumers to use HTPs instead of traditional products. The governments may also raise excise duties suddenly; 4) lack of regulations, uncertain legal situation of entrepreneurs and consumers.

3.1. Poland

Excise taxation, as already mentioned, is subject to harmonization¹² in EU Member States, and the EU excise duty regulations are subject to periodical verification and amendment, every 5 years or so [Karczewska and Parulski 2021, 48]. However, harmonization does not apply to excise duties on novelty tobacco products. The excise duty rates for a given year

¹⁰ Directive 2014/40 EU of the European Parliament and of the Council of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC Text with EEA relevance.

¹¹ However, due to the current process of legislative alignment with the Tobacco Products Directive (TPD, 2014) in Norway, the ban is expected to be lifted by the end of 2021 – *Tobacco control in Norway*, www.helsedirektoratet.no/english/tobacco-control-in-norway[accessed: 15.08.201].

¹² For tobacco products, see Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco.

are presented together with the assumptions of the Budget Act for a given financial year. According to Article 2(1)(36) of the Polish Excise Duty Act, novel products include: a) a mixture which contains tobacco or dried tobacco, b) the mixture referred to in point (a) and containing e-cigarette liquid separately- other than products delivering aerosol without combusting the mixture, referred to in Articles 98(1) and 99a(1); This definition thus covers, among others, HTPs.

As of 2018, excise duty in Poland was also extended to the so-called novelty tobacco products, initially at a zero rate.¹³ The Polish Excise Duty Act was amended by adding, among others, Article 99c(3) and (4) according to which: the basis for taxation of novelty products is their quantity expressed in kilograms, whereas the excise rate was calculated as exactly PLN 141.29 for each kilogram and 31.41% of the weighted average retail selling price of tobacco for smoking. Nonetheless, until 31 December 2018, the excise duty rate remained at a zero level. Thereafter, by the Act of 22 November 2018,¹⁴ the zero-excise duty on tobacco products was extended until 30 June 2020. The Minister of Finance of Poland issued an order on 30 June 2020 on abandoning the collection of excise duty on electronic cigarette liquid and novelty products¹⁵ effective from 1 July 2020 to 30 September 2020.

Pursuant to the Act of 21 November 2019 amending the Polish Excise Tax Act, the excise duty rate was increased as of 1 January 2020. Currently it amounts to PLN 155.79 for each kilogram and 32.05% of the weighted average retail selling price of tobacco for smoking, as expressed by Article 99c(4) of the Polish Excise Duty Act. This allows the price to be adjusted to the current tobacco market and there is no need to put a maximum price on the product.

3.2. Italy

The Italian market is the most significant HTP market in Europe. It is estimated to have a value in excess of one billion dollars [Liu, Lugo, Spizichino, et al. 2018, 274]. HTPs fall under the legal category of tobacco products for smokeless inhalation (in Italian: *i tabacchi da inalazione senza combustione*). According to Article 39bis(2)(e) of the Decree of 26 October 1995 on taxes, smokeless tobacco products which can be used without combustion include heated tobacco for inhalation.¹⁶ Until 2018, Italy was among

¹³ Under the Act of 12 December 2017 amending the Excise Duty Act, Journal of Laws of 2018, item 137.

¹⁴ Journal of Laws of 2018, item 2404.

¹⁵ Journal of Laws of 2020, item 1159.

¹⁶ Consolidated text of Decree no. 504 of 26 October 1995 on taxes on production and consumption and the related penal and administrative penalties, in Italian: Decreto

the countries with the highest excise duty rates on HTPs. In 2018, the Italian government decided to reduce this rate to the European average. Currently (i.e., as of 1 January 2021), the excise duty rate is 30% of that imposed on traditional cigarettes,¹⁷ but it will gradually increase by 5% each year. Effective 1 January 2023, the excise duty on HTPs is to be equivalent to 40% of the excise duty rate on conventional cigarettes.¹⁸

3.3. France

For tax purposes, the tobacco in refills for HTPs is included in the category “other tobacco products, novelty products” (in French: *les autres produits du tabac, nouveaux produits du tabac*). It includes all products that could not be classified in other categories (products which are not cigarettes, cigars and cigarillos, roll-your-own tobacco, chewing tobacco or snuff). This categorization is not satisfactory because heated tobacco is not *smoking* tobacco, yet it is legally classified as a combustible tobacco product just like pipe tobacco or water pipe tobacco.

Currently, there has been an increase in the excise tax rates in the “other smoking tobacco” category. Pursuant to Article 575A of the French Tax Act, the excise duty rate is a hybrid. The ad valorem rate is 51.4% of the retail price of 1 kg of pipe tobacco and the specific tax is €31.30 per kg; the minimum excise duty threshold is €135.20 per 1000 pieces.¹⁹ There are plans to gradually increase the specific excise duty rate until 2026. Currently, its rate is also higher than the European average. In autumn 2020, a proposal to reduce the excise tax rate on HTPs was submitted, but was not approved by the National Assembly.²⁰ France, which is one of the most restrictive European countries in terms of applying high excise duty rates to HTPs, continues to struggle with the broad problem of nicotine addiction.²¹ The French

legislativo n.504, 26.10.1995, *Testo unico delle disposizioni legislative concernenti le imposte sulla produzione e sui consumi e relative sanzioni penali e amministrative*, version as of 25 January 2021, online: www.adm.gov.it/portale/documents/20182/6661054/D.Lgs.+504+del+1995.pdf/8cb16e54-a972-4fc6-91cd-5cb162d05bc5 [accessed: 08.08.2021].

¹⁷ Traditional cigarettes are subject to specific excise duty currently amounting to €44.63 per 1000 cartridges – Italian State Budget Act for the financial year 2021 and multi-year budget for the three-year period 2021-2023, in Italian: *Bilancio di previsione dello Stato per l'anno finanziario 2021 e bilancio pluriennale per il triennio 2021 - 2023*, no. 178 of 30 December 2020, *Gazzetta Ufficiale serie generale* n. 322.

¹⁸ *Ibidem*.

¹⁹ French Excise Duty Act, Code général des impôts, www.legifrance.gouv.fr/codes/article_lc/LEGIARTI000043662353/ [accessed: 13.08.2021].

²⁰ *French Assembly rejects call to reduce tax on heated tobacco from 2021*, www.tobaccointelligence.com/french-assembly-rejects-bringing-down-heated-tobacco-tax-from-2021/ [accessed: 13.08.2021].

²¹ *Repenser la fiscalité des nouveaux produits du tabac et de la nicotine pour lutter contre*

National Academy of Medicine encourages nicotine addicts to consume HTPs or e-cigarettes as alternatives to traditional tobacco products to facilitate smoking cessation.²²

3.4. Lithuania

An amendment of 28 June 2019 introduced a legal definition of heated tobacco into Lithuanian legislation. Pursuant to Article 3(2) of the Excise Tax Amendment Law no. IX-569,²³ *heated tobacco products (in Lithuanian: Kaitinamojo tabako produktai) are tobacco products intended for use in a dedicated electronic device in which they are heated, without a combustion process, and are not cigars, cigarillos, cigarettes, or smoking tobacco. This product has been subject to specific excise duty, the rate of which in 2021 is €113,20 per 1 kilogram of tobacco.*²⁴

3.5. Germany

In 2021, Germany – citing the need to protect public health and specifically to prevent tobacco use among the underage – began work on amending the Tobacco Tax Act.²⁵ The amending Act, that is, *Tabaksteuermodernisierungsgesetz* (TabStMoG²⁶) was passed by the Bundestag in June 2021. Its goal is to close the excise duty gap between traditional cigarettes, e-cigarettes, and HTPs (in German: *Erhitzter Tabak*) in the 2022-2026 period. In 2026, heated tobacco is to be taxed at the same excise rate as traditional cigarettes. As far as heated tobacco is concerned, this category was legally separated from the more general category (it was treated as pipe tobacco)

le tabagisme, www.fr.irefeurope.org/Publications/Etudes-et-Monographies/article/Repenser-la-fiscalite-des-nouveaux-produits-du-tabac-et-de-la-nicotine-pour-lutter-contre-le [accessed: 13.08.2021].

²² *L'Académie nationale de médecine rappelle les avantages prouvés et les inconvénients indûment allégués de la cigarette électronique (vaporette)*, www.academie-medecine.fr/academie-nationale-de-medecine-rappelle-les-avantages-prouves-et-les-inconvenients-indument-allegues-de-la-cigarette-electronique-vaporette/ [accessed: 13.08.2021].

²³ Act amending the Excise Duty Act – Lietuvos Respublikos akcių įstatymo nr. IX-569 1, 2, 3, 30, 31 straipsnių, ii ir iii skyrių pakeitimo [statymas (dated 28 June 2018 no. XIII-1327), www.e-seimas.lrs.lt/portal/legalAct/lt/TAD/39131ae27adb11e89188e16a6495e98c [accessed: 17.08.2021].

²⁴ *Excise duty. Ministry of Finance of the Republic of Lithuania*, online www.finmin.lrv.lt/en/competence-areas/taxation/main-taxes/excise-duties [accessed: 17.08.2021].

²⁵ Tabaksteuergesetz, 15 July 2009 (BGBl. I S. 1870) as amended.

²⁶ Gesetz zur Modernisierung des Tabaksteuerrechts (Tabaksteuermodernisierungsgesetz – TabStMoG), www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Gesetze_Gesetzesvorhaben/Abteilungen/Abteilung_III/19_Legislaturperiode/2021-08-17-TabStMoG/3-Verkuendetes-Gesetz.pdf?__blob=publicationFile&v=3 [accessed: 18.08.2021].

and redefined as a tobacco product cut into pieces, individually wrapped, the use of which consists in the inhalation of aerosol or smoke produced by a dedicated device.²⁷ Effective 1 January 2022, excise duty on HTPs will be equivalent to the amount of excise duty levied on pipe tobacco and the amount of special tax equivalent to 80% of the amount of tax on conventional cigarettes reduced by the amount of excise duty on pipe tobacco - per unit of product [Karczevska and Parulski 2021, 52].

The change was based on research conducted by the German Federal Institute for Risk Assessment (BfR²⁸). The Institute concluded that flavored heated tobacco refills contain addictive substances, just like traditional tobacco products. There is an important fiscal aspect to the amendment that needs to be highlighted - available data suggests that the growth of heated tobacco sales in Germany over the past two years has reduced government revenues from excise duties on conventional cigarettes [ibid., 51].

3.6. Latvia

Article 4(4)(10) of the Latvian Excise Duty Act²⁹ defines heated tobacco (in Latvian: *karsējamā tabaka*) as excisable industrially processed tobacco, which produces an aerosol containing nicotine without combusting the tobacco. According to Article 13(1)(5) of the Act, as from 1 March 2021, there is a specific excise duty of €160 per 1 kilogram of tobacco. This rate is increased incrementally starting 1 January 2020. As of 1 January 2022, it will amount to €207 per 1 kilogram of tobacco, and as of 1 January 2023 - €218 per 1 kilogram of tobacco.

CONCLUSIONS

Excise duty is a single-stage, selective, regressive indirect tax, the burden of which is ultimately borne by consumers who purchase taxable products. Taxes are a certain addition to the cost of production and are at odds with industrial growth, as lower costs would increase both production and consumption.

Excise duties serve a fiscal purpose, but are also intended to create a change in consumption trends or are even used as a means to eliminate certain behaviors. In the Anglosphere, excise duty is commonly referred to as a *sin tax*, in economics, it is also called the Pigouvian tax. In the case

²⁷ § 2a of the German Tobacco Tax Act.

²⁸ In German: *Bundesinstitut für Risikobewertung*.

²⁹ Amendment to the Latvian Excise Duty Act (from Latvian: *Par akcīzes nodokli*), www.likumi.lv/ta/id/319404-grozijumi-likuma-par-akcizes-nodokli [accessed: 17.08.2021].

of tobacco products, WHO attributes the latter role to excise duty. WHO has repeatedly advocated that excise duty on all tobacco products, including HTPs, should be increased, acknowledging the price-affecting role of this tax. Another issue is that the policies of many governments include excise duty as a means to address the negative impacts (health, environmental, social) caused by the purchase of excisable goods. A moderate excise duty rate may be sufficient to generate stable revenues without creating significant difficulties for economic development.

Concerns about cross-border trade and the growth of a black market between countries with large price disparities may make it difficult to impose a high tax rate in some countries in the absence of effective regional cooperation.

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