TOBACCO TAXES IN THE EUROPEAN UNION

An evaluation of the European Commission’s Tobacco Tax Directive proposals for cigars, cigarillos, pipe tobacco, electronic cigarettes, heated tobacco products, and nicotine pouches

POLICY BRIEF

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Key findings

- The market for tobacco and nicotine-related products, excluding cigarettes and fine-cut tobacco (FCT), has experienced significant growth in the European Union (EU) due to the emergence of electronic cigarettes and heated tobacco products (HTP), along with a recent increase in sales of nicotine pouches in some member states.
- Cigars, cigarillos, and pipe tobacco are currently covered by the Tobacco Tax Directive (TTD), but unlike cigarettes or fine-cut tobacco, the minimum tax for these products can be set as a percentage of their retail selling price.
- Using retail selling price as the tax base permits companies to manipulate tax through undervaluation to minimize tax burdens. Moreover, this permits the proliferation of cheaper brands of these products, mitigating the effects of tax hikes on consumption.
- Novel tobacco products such as liquids for electronic cigarettes, nicotine pouches, and heated tobacco products are not covered by the current TTD, leading to diverse tax treatments across EU member states.
- The European Commission proposals for a revised TTD create separate tax categories for heated tobacco products, liquids for electronic cigarettes, and nicotine pouches. These proposals allow the minimum tax on these products to be set as a percentage of the retail sale price as well.
- Again, the onus is on member states to close this loophole, which is politically challenging across so many different jurisdictions.
- The opportunity afforded by the revision of the TTD should be used to close these loopholes, especially considering the strong growth outlook for novel tobacco products.

Background

As one of the crucial steps in Europe's Beating Cancer Plan, whose objectives include a Tobacco-Free Generation, the European Commission has recently been leading the process to revise the European Union's Tobacco Tax Directive (TTD).

Regrettably, the launch of the proposal for a new TTD was postponed indefinitely in late 2022. However, a draft of the revised text has circulated unofficially since, offering the possibility to analyze the reforms proposed therein, which were intended to operate as of 2025. A previous policy brief in this series analyzed the cases of cigarettes and fine-cut tobacco (FCT). The focus here is on the most important components of the rest of tobacco and nicotine-related products: cigars, cigarillos, pipe tobacco, electronic cigarettes, heated tobacco products (HTP), and nicotine pouches.

Market trends

At 13.7 percent of total European Union (EU) sales of tobacco and nicotine-related products by value in 2022, the market for tobacco and nicotine-related products other than cigarettes and FCT in the EU is relatively small. However, it is growing at a rapid pace, increasing from 5.1 percent of total sales in 2015. This is explained by the advent and consolidation of electronic cigarettes and HTP and, more recently, a very substantial increase in the sales of nicotine pouches in some member states. While the sales of traditional products such as cigars or cigarillos are expected to decline slowly, sales of electronic cigarettes, HTP, and nicotine pouches are forecasted to continue to grow robustly. In particular, the annual growth rates for HTP volumes are expected to reach double digits over the next four years

Current fiscal treatment

Cigars, cigarillos, and pipe tobacco are covered by the current TTD, but the structure of their minimum rates differs from that of cigarettes and FCT in an important way: the value of their minimum tax may be set as a percentage of the product's retail selling price. This facilitates the minimization of the tax burdens by means of undervaluation—a tobacco industry tactic consisting of marketing brands at very low prices—in the member states that have not closed this loophole.

Novel tobacco and nicotine-related products are not covered by the current TTD, and a variety of ad hoc treatments have emerged across member states. For liquids for electronic cigarettes, some states levy excise tax on them using volume as the tax base while others do not levy them at all. Although nicotine pouches are not commercialized in all states, there are no excise taxes on them in most of the states where they are commercialized. In the case of HTP, some states use the rules applicable to pipe tobacco whereas others have partially progressed towards equal tax treatment with cigarettes, as the World Health Organization (WHO) recommends. Overall, however, HTP receive a more favorable fiscal treatment than cigarettes in the EU. Such fiscal advantage is not fully reflected in retail prices, as HTP prices closely track those of cigarettes.

The European Commission's proposals

The European Commission's proposals for the revision of the TTD include the creation of separate tax categories for each of these novel products. They also include substantial increases in the minimum tax rates applicable to the traditional products, with adjustments for inflation and purchasing power differences across member states.

However, the proposals preserve —and export to the novel products—the loophole that permits setting minimum excise duties as a fraction of the product's retail price mentioned above. Unless member states act to close this loophole, the proposed TTD cannot be expected a priori to lift the excise tax floor of the products discussed in this brief.

A simulation of the effects of the proposals on the excise yield—the amount of excise tax that would be obtained from a product selling at average prices—that the new rules would generate, shows little impact on cigarillos, cigars, or pipe tobacco. For novel products, the effects of the proposals are more nuanced. In the case of electronic cigarettes and nicotine pouches, the most tangible impact is the imposition of excise duties in countries where they currently do not apply. On the other hand, for HTP, the impact on excise yields at current prices is noticeable in most countries.

It is reasonable to assume that the industry will respond by offering cheap brands to minimize the tax burden in the new scenario.

Conclusions and policy recommendations

The European Commission's proposals for the revision of the TTD include the creation of separate tax categories for HTP, liquids for electronic cigarettes, and nicotine pouches. The proposed revisions also include substantial increases in the rates for traditional tobacco products and adjustments for inflation and purchasing power differences across member states. These are very welcome innovations from the perspective of public health, and the argument about the desirability of re-launching the legislative process as soon as possible that was made for the case of cigarettes and FCT in this brief's companion publications is equally appropriate here.

Notwithstanding the recommendation above, the proposed architecture of the minimum rates for the products considered here is found wanting from the point of view of tobacco control: the revised TTD would allow their excise tax to be a fraction of the retail selling price. The onus would be on member states to close this loophole, which permits industry undervaluation as a strategy to minimize tax burdens. This might be politically challenging across so many different jurisdictions

Perhaps the most important reason why the EU's TTD is recognized as a crucial piece of legislation for tobacco control is its potential to create an excise tax floor for tobacco products. This is certainly the case for cigarettes, for which both a fixed minimum and a relative minimum based on the product's weighted average price must be satisfied. This ability is partly sapped in the case of FCT because the excise tax floor must reach either one or the other minimum rather than both. The products considered here are affected by this limitation, but in their case, the detrimental effect for tobacco control purposes is magnified because the base for the relative minimum is the brand's retail price rather than a measure less amenable to industry manipulation such as the weighted average price. The upshot is that the ability of the proposed TTD legislation to set an effective excise floor is severely undermined for these products. Foregoing the chance to close this loophole with an EU directive whose revision is supposedly motivated by public health reasons—rather than hoping that domestic policies do the job—would be regrettable, especially when the market outlook for the novel products is one of strong growth.

Acknowledgments

UPCT is funded by the Tobacconomics program at Johns Hopkins University (JHU) (previously housed at the University of Illinois Chicago, or UIC) to conduct economic research on tobacco taxation. JHU is a partner of the Bloomberg Initiative to Reduce Tobacco Use. The views expressed in this document cannot be attributed to, nor can they be considered to represent, the views of JHU, UIC, or Bloomberg Philanthropies. Suggestions by Jeff Drope and Alison Goldstein to an earlier version of this brief are gratefully acknowledged.