# Evaluation of Council Directive 92/83/EEC on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages

- Final Report -

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# List of Abbreviations

**Table 1: List of abbreviations**

| Abbreviation | Meaning |
|---|---|
| **ABV** | Alcohol by volume |
| **APC** | Alcohol consumption per capita |
| **BTI** | Binding tariff information |
| **CN** | Combined Nomenclature |
| **e-AD** | Electronic administrative document |
| **ECAS** | European Comparative Alcohol Study |
| **ECJ** | European Court of Justice |
| **EMCS** | Excise Movement and Control System |
| **EPC** | Excise Product Code |
| **EU** | European Union |
| **HMRC** | Her Majesty's Revenue and Customs |
| **HS** | Harmonised System |
| **IPA** | Isopropyl alcohol |
| **ITEG** | Indirect Tax Expert Group |
| **MEK** | Methyl ethyl ketone |
| **NGO** | Non-governmental organisation |
| **OECD** | Organisation for Economic Co-operation and Development |
| **PVC** | Polyvinyl chloride |
| **RTD** | Ready-to-drink |
| **RUSI** | Royal United Services Institute |
| **SME** | Small and medium-sized enterprises |
| **VAT** | Value-added tax |
| **WCO** | World Customs Organisation |
| **WHO** | World Health Organisation |

# Abstract

European Union (EU) legislation harmonises the structures of excise duty on alcoholic products in order to balance the legitimate needs of Member States to pursue their national policies for charging and collecting excise duties with the common interest of having a fully functioning internal market that is free of competitive distortions and tax-driven obstacles to trade.

EU legislation does so by *inter alia* drawing a line between excisable and non-excisable alcohol products, by establishing common definitions of alcoholic beverages for excise purposes, by establishing the manner in which excise duty must be applied to each of those products, by imposing qualitative and quantitative limits on the application of exemptions and reduced rates and through a range of other ancillary provisions.

Given that the legislative act in question, Directive 92/83/EEC, has remained unchanged for more than 24 years, questions have been raised as to whether it is still fit for purpose in an EU market and international context whose characteristics have evolved and expanded well beyond those observable at the time of its adoption in 1992.

As part of the EU Commission's continuous effort to ensure that EU legislation remains fit for purpose, the present report seeks to answer these questions by evaluating the provisions of Directive 92/83/EEC. This report, thus, assesses whether the Directive's intended objectives remain relevant today; the extent to which the legislative act meets its original and current needs and whether it does so in an efficient and proportionate manner.

# Executive Summary

## 1. Introduction

1.1 The EU's responsibility in the area of excise duties is established in Article 113 of the Treaty on the Functioning of the European Union[1]: "*the Council shall adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*".

1.2 The basic principles applicable to all products that are subject to excise duties are laid down in Directive 2008/118/EC[2]. The specific arrangements for the taxation structure of alcoholic beverages are contained in

- Directive 92/83/EEC (hereafter referred to as "the Directive") defining *inter alia*, excise categories, the scope for reduced rates and exemptions while
- Directive 92/84/EEC fixes minimum rates for alcohol.

1.3 The subject of this study is the retrospective evaluation of **Directive 92/83/EEC** and its functioning under the current legal framework for enabling the Commission to assess the current and future policy for alcohol excise duties.

1.4 Accordingly, the study evaluates:

- the extent to which the Directive meets the objectives it sought to achieve
- if original objectives continue to be relevant
- weaknesses in the Directive resulting in negative consequences for stakeholders
- the coherence of the Directive with EU and international law
- the added value of common rules at EU level
- Recommendations on how to address the issues identified.

## 2. Methodology

2.1 In addition to an economic and legal analysis, the evaluation of the Directive has relied on a comprehensive consultation of all relevant stakeholders at each step of the process involving:

- Exploratory interviews with Commission staff
- Fiscalis Seminar with tax administrations of Member States
- Written consultation of all 28 Member States' administrations (tax and health authorities)
- Online survey of directly-impacted stakeholders (economic operators and organisations representing their interests)
- An open public consultation
- In-depth interviews with various stakeholders in the context of case studies.

2.2 The conclusions of the study are based on the triangulation of data using multiple analytical methods; they express the conclusions drawn by the authors of this study.

## 3. Structure

3.1 The report follows the logical order of the legislative act: (i) definitions of different categories of alcoholic beverages, (ii) reduced rates, (iii) exemptions and other legislative provisions. The impact of the Directive on the ability of Member States to pursue health objectives is presented separately.

[1] This Article is equivalent to Article 99 of the Treaty on European Union (Maastricht Treaty) in force in 1992 when Directive 92/83/EEC was adopted.

[2] Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, Official Journal of the European Union L 9/12, 14.1.2009

## 4. Classification

4.1 For calculating excise duties, alcohol and alcoholic beverages are classified as: "beer", "still and sparkling wine", "other fermented beverages", "intermediate products" and "ethyl alcohol"[3].

4.2 Overall, the classification rules concerned continue to meet the needs they were intended to. However, both Member States and economic operators pointed out the following weaknesses:

- they don't accurately capture all existing products,
- they don't provide a sufficient degree of legal certainty and clarity, particularly in the light of technological and market developments.

4.3 These weaknesses result in an increased risk of lost revenue, in unfair taxation, increased administrative costs and in an increased potential for competitive distortions. The report concludes that systemic flaws in the legislative environment are at the origin of these weaknesses.

4.4 For addressing them, the evaluation suggests clarifying the category of "*other fermented beverages*" and the notion of "*entirely fermented origin*".

## 5. Reduced rates

5.1 The Directive allows Member States to grant reduced rates to certain categories of producers (i.e. small producers and fruit growers) and to certain products (i.e. alcoholic beverages below a certain alcoholic strength, and products of a regional or traditional nature. It also exempts certain categories of alcoholic beverage produced for own consumption from the scope of application of excise duty.

5.2 At the overall level, the Directive is achieving its objective of ensuring a uniform approach, the approximation of national excise duty structures and the avoidance of distortion of competition between Member States. However, at a granular level, a more nuanced assessment is necessary.

### 5.1. Reduced rates for small producers

5.1.1 The Directive gives Member States the option to apply reduced rates to brewers producing no more than 200,000 hectolitres of beer per year and to distillers producing no more than 10[4] hectolitres of pure alcohol per year[5]. This possibility is not available for small producers of other types of alcohol.

5.1.2 Our economic analysis suggests that reduced rates for small producers are unlikely to be having a detrimental impact on competition. Nevertheless, while the above conclusion may be valid at the level of the overall market, there could well be distributional effects that encourage certain producers to feel that the presence or absence of reduced rates is creating unfair competitive pressure on their operations.

5.1.3 The evaluation finds that, to the extent that the rationale for the reduced rates holds for small brewers and distillers (i.e. levelling the playing field and allowing small producers of these products to compete more effectively against larger producers), it may be appropriate to extend this advantage to small producers of other beverages too, as economies of scale are also likely to be present in those sectors.

[3] Articles 2, 8, 12, 17 and 20, respectively, define the product categories.
[4] 20 hectolitres per year if such a reduced rate was already provided when the Directive was adopted
[5] Articles 4 and 22 respectively

**5.2. Reduced rates for low-strength alcoholic products**

5.2.1 The Directive allows Member States to apply reduced rates for all categories of alcoholic beverage with an alcoholic strength below a given level[6].

5.2.2 The stated purpose of the Directive in setting common upper limits in this context is to protect the functioning of the internal market. This objective appears to have been achieved at EU level.

5.2.3 However, at the level of their implementation (i.e. when put into practice by Member States), the introduction of reduced rates for alcoholic beverages below a certain alcoholic strength is intended to encourage the production and consumption of lower-strength beverages within each category. The Directive does not explicitly state that these provisions are to be viewed in this light or as a tool for pursuing health policy objectives. This may negatively affect their uptake by Member States, the adequacy of their implementation nationally and the level of support they receive from the public and industry.

5.2.4 While the current provisions have been reported to be largely accepted as appropriate by stakeholders, this evaluation has found several weaknesses in relation to each of them.

5.2.5 As the full extent of these weaknesses could not be analysed in the context of this evaluation due to the absence among the stakeholders of a common understanding of the core policy purpose of these provisions, we recommend further investigation to assess the extent to which the provisions for reduced rates can be used to pursue re-established and clear policy objectives.

**5.3 Reduced rates and exemptions for private production for own consumption**

5.3.1 Member States generally make use of the existing scope for applying exemptions for the private production of beer, wine and fermented beverages. No major negative consequences from the existence of these provisions have been reported.

5.3.2 Opinions of Member States are divided on the possibility of extending exemptions to cover intermediate products and ethyl alcohol.

5.3.3 Countries that favour extending the exemptions cite the important role of traditional home-made spirits and production methods in their national culture while also considering that such exemptions would normalise and regulate alcohol production which would otherwise take place illegally. Countries that oppose the expansion of exemptions cite the perceived increased risk of (cross-border) fraud, health risks and higher administrative costs and burdens as arguments

5.3.4 Given the polarised views among Member States, more detailed investigation of the potential impacts of allowing Member States to exempt the private production of ethyl alcohol and intermediate products for own consumption is recommended.

**6. Exemptions for denatured alcohol**

6.1 Due to significant inconsistencies in the treatment of the exemptions for completely denatured alcohol across the Member States, there is a strong need for clearer and more effective common rules.

6.2 The inconsistent interpretation of Articles 27.1 (a) and (b) is resulting in significant uncertainty and financial implications for economic operators. For the producers and users of denatured alcohol, decisions about where to set up production or where to purchase denatured alcohol can be affected. The free movement of goods in this context is being negatively affected.

[6] Articles 5, 9.3, 13.3, 18.3 and 22.5

6.3 The administrative burden and cost for Member States and economic operators could be lessened by ensuring the existence of a common understanding of the provisions, as well as by increased harmonisation.

6.4 The abuse of the exemptions for denatured alcohol is suspected to create the scope for fraudulent activity. It is difficult, however, to draw firm conclusions on the overall level of alcohol fraud, other than that its extent is non-trivial in a number of Member States.

## 7. Establishment of excise duty on beer

7.1 Member States have the option to establish excise duty on beer either by reference to the number of degrees Plato or based on the alcohol strength by volume. There is no evidence that choices made result in negative consequences to other Member States or to operators established in other Member States.

7.2 This evaluation concludes that, overall, the current provisions on establishing duty for beer remain appropriate in their current form.

7.2 The correct interpretation of Article 3.1 should, however, be clarified in order to ensure the uniform calculation of excise duties in countries which use as reference the number of degrees Plato.

## 8. Conclusions

8.1 Effectiveness

8.1.1 The Directive is instrumental in enabling the collection of excise duty on alcohol and alcoholic beverages in the context of the internal market. At a general level, the Directive allows intra-community trade to take place free of significant tax-related trade barriers or major competitive disruptions between economic operators operating in the same sector of activity.

8.1.2 Moreover, our estimates of the overall levels of fraud indicate that the tax losses stemming from the application of the exemptions for denatured alcohol, although they are non-trivial, are minor in the context of the size of the tax gap associated with alcohol fraud overall.

8.1.3 Several weaknesses in the legislative environment partially undermine the above-mentioned conclusions as exemplified by situations where:

- The same (or similar) products are treated differently for excise purposes in different Member States
- Certain products deemed "difficult to classify" are perceived as abusing favourable excise tax categories, causing competitive distortions and loss of revenue.
- Inconsistencies between the CN classification and the excise classification create difficulties and a lack of clarity regarding the excise classification of certain products.
- Member States are unable to apply reduced rates to small producers for all categories of alcoholic beverages, unnecessarily limiting their ability to correct potential market imbalances where such a policy objective is pursued.
- The inconsistent implementation of rules on exemption of denatured alcohol leads to unfair competition, uncertainties and financial risks for economic operators, impacting business decisions and can hinder the free movement of goods.

8.2 Efficiency

8.2.1 The application of Directive 92/83/EEC is generally straightforward. This evaluation, however, has identified multiple areas which lead to increased costs for both economic operators and Member States. As a result, it cannot be concluded that the Directive is efficient.

8.2.2. The increased administrative and compliance costs are not a result of systematic obligations inscribed in legislation; rather, they are the result of the complications,

disputes and the inconsistent application of the Directive's provisions. The geographical extent and number of examples supporting this assessment indicates that these complications are the result of a failure of the Directive to provide sufficient clarity to the stakeholders.

8.3 Relevance

8.3.1 The Directive's objectives continue to be highly relevant. In this context, all different groups of stakeholders considered the interventions of the Directive to remain necessary.

8.3.2 Consideration was given to whether the objectives of the Member States have evolved in relation to excise duty on alcohol, insofar as they might today also include the objective of influencing alcohol consumption habits via adjustments in excise duty rates and structures.

8.4 EU added value

8.4.1 An EU-wide system provides the uniformity and harmonised conditions that are necessary to ensure the proper functioning of the internal market. In the context of the internal market, it would not have been possible to achieve the same results in terms of effectiveness and efficiency – let alone more positive ones – via an alternative, bilateral or international approach. Moreover, the stakeholders' divergent interpretations of the Directive show that its effectiveness could be improved by expanding the EU-level approach.

8.5 Coherence

8.5.1 Overall, the Directive has been shown to be coherent with EU legislation and international agreements. However, specific issues were identified as a result of certain changes in the Combined Nomenclature and amendments to EU legislation that took place after the introduction of the Directive. In the interest of clarity, these inconsistencies should be resolved.

## 9. Recommendations

9.1 While some identified issues could be mitigated through soft law or through actions taken at Member State level, a targeted revision of the Directive is recommended in order to enable it to fully respond to the challenges identified.

9.2 Specific recommendations are issued for each area of the Directive. These are treated separately and individually in the main body of the report. While some areas may require additional harmonisation and stricter enforcement in order to pursue common internal market objectives, recommendations in other areas seek to give Member States more liberty in pursuing their national policies where no (or limited) risks for other Member States or the functioning of the internal market can be observed.

9.3 While the pursuit of all recommendations should be considered, this report views as priorities actions targeted at (i) resolving identified internal market issues resulting from the management of exemptions for denatured alcohol and (ii) classification issues.

# 1. Introduction

This is the final report of the evaluation of *Directive 92/83/EEC on the harmonisation of structures of excise duties on alcohol and alcoholic beverages*.

This introductory section presents the structure and content of this report and briefly introduces the reader to the objectives, methodology and limitations of the evaluation. The last part of this introduction comprises a brief overview of the Directive and its objectives.

## 1.1 Structure and content of the report

This report presents the findings of the evaluation of Directive 92/83/EC. These findings are presented in the same sequence that its provisions are laid out in the legislative act (i.e. classification of categories of excise duties, reduced rates, exemptions and other legislative provisions).

Table 2 provides an overview of how the information in this report is structured.

**Table 2: Structure and content of the report**

| Section | Content |
|---|---|
| **1** | This chapter introduces the present report, including its structure, content, objective, overall approach and methodology, and discusses the limitations involved in the analysis conducted. It also introduces the objectives of the Directive. |
| **2** | This chapter discusses the findings of the evaluation regarding the provisions classifying alcoholic beverages for excise duty purposes. It analyses the provisions for the establishment of categories of alcoholic beverages according to the evaluation criteria: relevance, effectiveness, efficiency and EU added value. |
| **3** | This chapter presents all the findings of the evaluation in relation to the application of the provisions relating to reduced rates. The provisions for each type of reduced rate are analysed separately. This chapter distinguishes between the analysis of stakeholder views and the quantitative analysis of relevant economic data. |
| **4** | This chapter contains the analysis concerning the application, implementation and functioning of the system for exempting denatured alcohol from the scope of excise duty. |
| **5** | This chapter contains an analysis of the excise duty gap relating to fraud revolving around alcohol and alcoholic beverages. In terms of its relevance to the present evaluation, the focus of this section is the level of fraud which can be attributed to the abuse of the exemptions for denatured alcohol. |
| **6** | This section contains a separate analysis of the provisions relating to the establishment of duty for beer. |
| **7** | This chapter discusses the degree of external coherence of the Directive with any other legislative acts at EU or international level. |
| **8** | This chapter discusses the extent to which the Directive, in its current form, affects the implementation of health policy. In order to provide the level of granularity necessary for a thorough analysis, individual provisions are analysed and presented separately. |
| **9** | This section presents the overall conclusions which can be drawn on the basis of all the findings presented in this report. It assesses the Directive in terms of the evaluation criteria of relevance, EU added value, effectiveness, efficiency and coherence. |
| **10** | The final section discusses the recommendations derived from the conclusions of this study, and presents their justifications as well as the potential impacts which they are expected to achieve if implemented. Also recommendations to maintain the status quo are given where appropriate. |

Each chapter begins with a summary of findings which presents the main conclusions of the chapter. To different extend the chapters assess the provisions of the Directive

according to the evaluation criteria: effectiveness, efficiency, relevance, EU-added value and coherence.

Chapters 2 and 4 present potential measures to approach the issues identified for the treated topic. The listed measures are analysed presenting possible benefits and disadvantages. Some of these measures have been taken up and further developed into recommendations, presented in Chapter 10.

The report includes the following appendices:

**Table 3: Overview of appendices**

| Appendix | Contents |
|---|---|
| **1** | This appendix contains an overview of the evaluation questions asked in this study. It also presents the evaluation design in the context of the intervention logic established. |
| **2** | In this appendix, we present the strategy followed in the consultation of stakeholders during the different steps of the evaluation, namely during the inception phase, the data collection through surveys and questionnaires, and the in-depth case studies. |
| **3** | This appendix presents the questionnaire which was disseminated to the Member States tax authorities. |
| **4** | This appendix includes the questionnaire which was disseminated in an online survey targeted at economic operators. |
| **5** | This appendix includes the questionnaire which was used for the open public consultation. |
| **6** | Appendixes 6a and 6b comprise the in-depth case study regarding classification issues, divided into 1) a presentation of the identified problems, and 2) a quantification of these problems. |
| **7** | This appendix presents the in-depth case study regarding reduced rates for small producers. |
| **8** | This appendix includes the in-depth case study regarding the management of exemptions for denatured alcohol. |
| **9** | Appendixes 9a and 9b present the results of the public consultation, including a summary report and an overview of all the responses. |

## 1.2 Objectives and scope of the evaluation

The subject of this study is the retrospective evaluation of Directive 92/83/EEC and its functioning under the existing general legal framework. The objective is to provide the Commission with information to assess its policy concerning the structure of alcohol excise duties.

In this respect, the evaluation:

- Assesses the extent to which Directive 92/83/EEC meets the objectives it sought to achieve
- Verifies whether the original objectives are of continued relevance
- Identifies weaknesses in the legislative environment caused by the Directive which result in negative consequences for the stakeholders (e.g. obstacles to the functioning of the internal market, competitive disruptions, administrative and compliance costs, etc.)
- Assesses the coherence of the Directive's provisions with EU and international law
- Examines the added value of establishing common rules at the EU level
- Formulates recommendations based on the collected evidence on how best to address the issues identified.

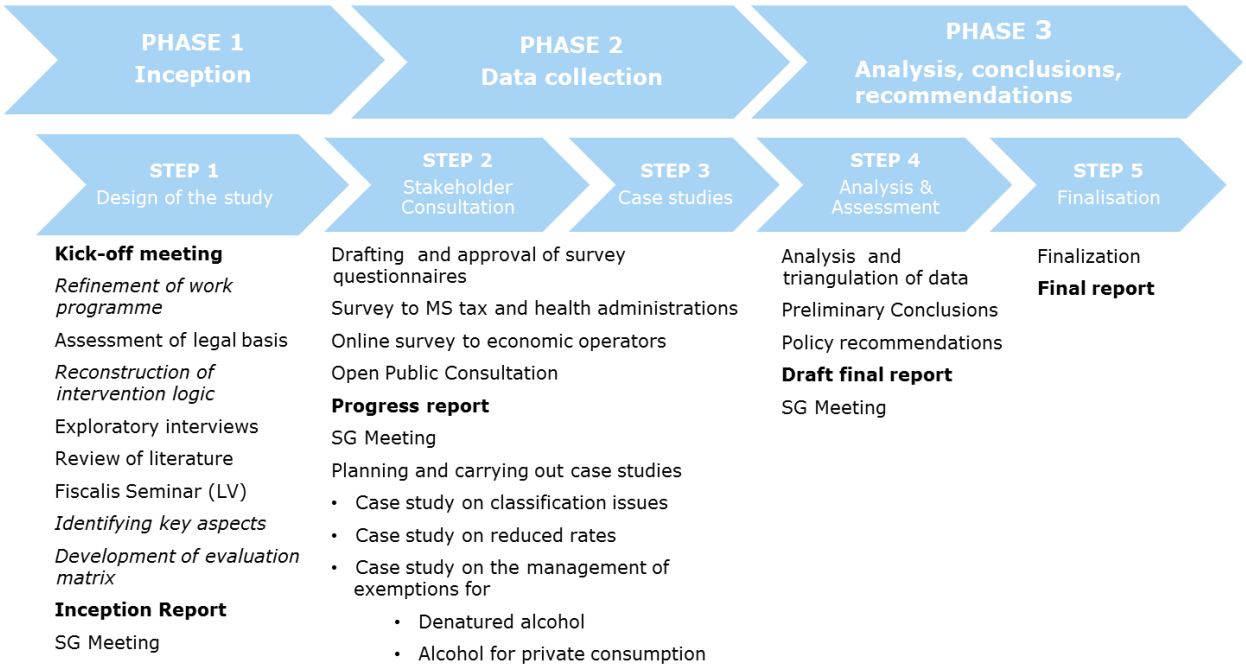
## 1.3 Overall approach to the assignment

This chapter briefly describes the methodological approach used for this evaluation. It offers a simplified overview of the data collection steps which were implemented by the project team. A more detailed insight into the conceptual design, the analytical strategy and the consultation strategy can be found in Appendix 1 – *Evaluation Matrix and Evaluation Design* and Appendix 2 - *Consultation strategy synopsis report*.

As Figure 1 indicates, the study has been arranged around the following main phases:

- Inception
- Data collection
- Analysis, conclusions and recommendations.

**Figure 1: Overall organisation of the work**




The inception phase was dedicated to the design of the study and the refining of the methodological basis. A thorough assessment of the legal base and other documents, an exploratory interview with the responsible officer at the Commission[7], and active participation in a Fiscalis seminar with representatives of the Member States have all supported the development of the intervention logic of the Directive, the identification of key issues for further investigation, and the full development and operationalization of the evaluation matrix. A full description of the methodological design of this study can be found in Appendix 1 – *Evaluation Matrix and Evaluation Design*.

The data collection phase involved, as a first step, the consultation of all the relevant stakeholders (the Member States, the economic operators and the associations representing them), as well as the conducting of an open public consultation in accordance with the European Commission's Better Regulation Guidelines[8].

Following a preliminary analysis of the results of this stage, the second step involved the in-depth analysis of four different issues (classification, reduced rates, the management of exemptions for denatured alcohol, and the management of exemptions for private

[7] DG Taxation and Customs Union; Unit C2 Indirect taxes
[8] Better Regulation Guidelines, COM(2015) 215 final, SWD(2015) 111 final, Strasbourg, 19.5.2015, available at http://ec.europa.eu/smart-regulation/guidelines/toc_guide_en.htm

production). These in-depth studies employed a range of activities and multiple sources of data, including semi-structured interviews and the analysis of economic data.

The analysis phase involved the triangulation of all the data collected in the course of the evaluation, the drafting of conclusions, and the development of policy recommendations.

## 1.4 Methodological challenges and countermeasures

Although they were partially mitigated, the data collection and analytical approach were subject to several inherent limitations which are worth mentioning. These, together with the countermeasures adopted, are briefly described in the section below. Appendix 2 - *Consultation strategy synopsis report* provides details of the stakeholder consultation process and participation rates.

**Representativeness of answers**
The findings of the survey of economic operators and their representatives are based on the answers from a sample of the population of the stakeholders affected, and not on the answers given by the entire population.

Taking this into account, the design of the survey sought to capture an EU-level picture; **overall,** the sample size and composition are considered to be **representative** given the limitations of the sample. The respondents represent good coverage of the various product categories, as well as all countries, and the coverage was also well distributed between small and large operators. Where a relative small number of economic operators within a sector was observed, the answers of industry organisations (which reflect the views of multiple operators within a particular sector of activity) supplement the sample and improve the representativeness of the survey. In this context, we believe that the analysis performed at the EU level and for each sector can be considered sufficiently accurate.

However, the coverage of economic operators involved with denatured alcohol is less representative. The number of respondents was much lower than for the other topics (less than 50 respondents) but still delivered relevant and accurate responses. The questions regarding exemptions under Article 27.1 (b) were answered almost exclusively by respondents from the cosmetics sector who have strongly aligned their answers, in some instances to the point where they are identical. For obtaining a sufficiently representative picture, the in-depth study regarding the exemption of denatured alcohol was based on a balanced coverage of the industries which make use of that commodity.

In addition, as with any survey, other factors may be responsible for errors in the results: for example, respondents may have been unable to answer a question accurately, or were unwilling to respond honestly. These risk factors are difficult to avoid, but they can to a certain extent be inferred through the analytical process connected with the data triangulation.

**Use of the survey responses**
We fully recognise the risk inherent in the fact that opinions, views and the positions taken in the survey are highly subjective. Our approach to the analysis, which is rooted strongly in **triangulation** (which we understand to mean **in terms both of sources and methods**[9]) has taken this risk into account.

The data collected about the backgrounds of the economic operators has allowed filtering answers to the survey based on the industry sector of the respective operators, their size, and, where relevant, the Member State(s) in which they are active. This has high

[9] While the triangulation of sources entails inferring a fact from the statements of various types of stakeholder in the course of a single data-collection activity (e.g. all sectors of activity covered in the survey administered to economic operators), the triangulation of methods also requires the inferring of that fact from analytical actions (e.g. the analysis of economic data should support the conclusions drawn from the results of the surveys).

relevance for the analysis of many (though not all) questions. The analysis of the survey population has shown that for most types of respondent, sufficient responses were received to permit a comparison of the answers given by economic operators within different sectors, or of different sizes. In some cases, it has also been possible to filter responses for two types of variable (e.g. small-scale beer producers). An **analysis per respondent type** has been possible for the responses to closed-ended questions, as well as for answers to open-ended questions (i.e. the analysis of qualitative answers also takes account of the type of respondent making the statement(s) being presented).

Though relevant perspectives and viewpoints are presented with the purpose of reflecting the type of stakeholder expressing them (e.g. the Member States, different types of economic operator, and trade associations), the **final conclusions are based on the triangulation** of data from several sources (e.g. different types of stakeholder) using several methods (e.g. using survey data as well as data derived from an economic or legal analysis), and reflect the interpretation and judgement of the authors of this study.

Finally, it should be noted that, with the exception of certain specific questions contained in the various questionnaires (see Appendix 3 – *Survey questions to Member States*, Appendix 4 – *Survey questions to economic operators* and Appendix 5 – *Open public consultation questions*), the stakeholders were not directly asked for their opinion concerning the Directive's provisions regarding health policy (this would have been outside the scope of this evaluation and the conception of the intervention logic). In most cases, the respondents were asked about their overall opinion concerning the provisions. Chapter 8, which discusses health policy, analyses the answers of all the stakeholders that mentioned health policy in their responses. Consequently, that chapter is biased towards those respondents advocating the inclusion of provisions which support health policy, while the opinions of those who did not have health policy on their immediate agenda are not represented.

**Verifiability of survey responses**

The assessment of the excise duty gap related to the fraudulent use of denatured alcohol draws heavily on Member States' estimates of the tax gap owing to alcohol fraud (in general) and the proportions of this fraud that stem from the abuse of exemptions for denatured alcohol. By definition, fraudulent activity is illicit in nature, and it is therefore inherently difficult to measure accurately. We have sought to draw on as wide a range of sources as is available in order to conduct our analysis, but it has not been possible to corroborate comprehensively the estimates provided by the Member States in the stakeholder survey. These results on the duty loss associated with the abuse of exemptions for denatured alcohol must therefore be treated with caution. This uncertainty is reflected in the relatively broad ranges in the analysis.

**Paucity of industry-level data**

A key aspect of the assessment of reduced rates for small producers is the extent to which the application of these reduced rates creates distortions in the competitive landscape. It is not possible to carry a quantitative assessment of the changes in the competitive landscape for each market in each Member State. A robust analysis would require data to be able to correctly define each market which is not possible with the data available (nor would it be within the scope of this study). Nonetheless, the data available were sufficient to allow some quantitative analysis (which is described in further detail in Appendix 7 – *In-depth case study on reduced rates for small producers*). In particular, we were able to conduct analysis of competition indicators which we developed using data for a subset of Member States from Euromonitor (in conjunction with other data sources, such as industry reports by trade associations). This included, for example, analysis of concentration ratios, firm size distribution and profitability in order to understand the impacts of reduced rates for small producers on competition, and ultimately draw inference about the possible effects of reduced rates for small producers on competition, given the current competitive environment with reduced rates in place.

**Transparency of Member State practice**
We did not have access to information on how Member States classified particular "difficult to classify" products. This limitation was partially overcome in the quantitative analysis of potentially misclassified products by constructing scenarios linked to data from Euromonitor. Even so, care must still be exercised over the estimates generated in these scenarios as the assumptions made to make the classification tractable may tend to over-state the tax impacts.

## 1.5 Objectives of the Directive

The EU's right to act in the area of excise duties is established in Article 113 of the Treaty on the Functioning of the European Union[10], which specifies that "*the Council shall adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*." At the same time, excise duties are intended to safeguard the budgetary objectives of the Member States.

The basic principles applicable to all those products which are subject to excise duties were first laid down in 1992, in Directive 92/12/EEC[11]. The legislative act currently in force is Directive 2008/118/EC[12], which repealed the 1992 Directive. Previous to these provisions, there were no common rules for excise duty at the Community level.

The arrangements for the taxation of alcohol products were introduced on 1 January 1993 in the run-up to the completion of the internal market:

- **Directive 92/83/EEC** (referred to as "the Directive" in the following) deals with the structure of excise duties on alcohol and alcoholic beverages; sets the basis for the calculation of excise duties by defining applicable excise categories; prescribes the possibilities for applying reduced rates, and lists applicable exemptions
- **Directive 92/84/EEC** fixes minimum rates for the excise duties on alcohol and alcoholic beverages.

Using the intervention logic (which is presented in detail in Appendix 1 – *Evaluation Matrix and Evaluation Design*), the following general objective was identified for Directive 92/83/EEC: To strike a balance between the harmonisation of legislation in order to ensure a functioning internal market and maintain the flexibility of the individual Member States to set excise duties at a level corresponding to their needs.

The **proper functioning of the internal market** for alcohol and alcoholic beverages can be achieved by attaining three objectives:

- a clear and consistent framework governing the calculation and collection of excise duties;
- fair competition between all economic operators;
- reducing the risk of excise duty circumvention.

By defining the scope of excise duty, classifying products, and setting conditions for reduced rates and exemptions, the Directive ensures that **clear rules are available both to Member States and to economic operators** regarding how alcohol and alcoholic beverages should be treated for excise purposes in the EU. Such clarity forms the basis for allowing products to be traded within the internal market.

[10] This Article is equivalent to Article 99 of the Treaty on European Union (Maastricht Treaty) that was in force in 1992, when Directive 92/83/EEC was adopted.
[11] 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, 23.3.1992
[12] Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, Official Journal of the European Union L 9/12, 14.1.2009

In setting these clear rules, the Directive also ensures **similar conditions for economic operators across the EU**. Their products are taxed on the basis of principles that apply in all the Member States.

The Directive also not only creates a level playing field for the economic operators of different countries, but through the setting of reduced rates and exemptions, certain producers and traders who are more vulnerable to strong competition can be given some support.

Finally, the functioning of the internal market is ensured when the risk of fraud perpetrated to evade excise duties on alcohol and alcoholic beverages can be kept at a low level.

At the same time, the Directive has to allow the **Member States to safeguard their budgetary objectives**. Excise receipts accrue to the Member State where the goods are released for consumption, and are seen as an important source of revenue. They make up, on average, approximately one quarter of the receipts from consumption taxes[13]. The Directive aims to ensure that clear and common rules are in place which define the goods on which a lower rate or zero rate of excise duty is payable. The provisions regarding denatured alcohol in particular envisage methods for ensuring that the Member States are able to combat the misuse of exemptions.

An important aspect of the present evaluation is to understand whether these objectives are still relevant, and to what extent they can be achieved through the Directive.

[13] Taxation trends in the European Union, Data for the EU Member States, Iceland and Norway, Eurostat 2013, p. 30.

# 2. Classification of alcohol and alcoholic beverages

This chapter presents the findings relating to the functioning of these classification rules. It covers the relevance, effectiveness, efficiency and EU-added value of the provisions. Difficulties with classification have been assessed in an in-depth case study. Findings on the products which are difficult to classify are presented in *Appendix 6a - In-depth case study on classification issues*. In a second part, the potential tax impact of the identified classification issues has been analysed: *Appendix 6b – In-depth case study on classification issues – quantification*.

For the purpose of calculating excise duties, alcohol and alcoholic beverages are classified under the following headings: "**beer**", "**still and sparkling wine**", "**other fermented beverages**", "**intermediate products**", and "**ethyl alcohol**". Articles 2, 8, 12, 17 and 20 respectively set out which products belong to which category. These definitions ensure that there is a common legal understanding, and that similar products fall within the same tax categories throughout the EU. The Articles that set out the product categories refer to the Combined Nomenclature (CN) codes. Article 26 further specifies that these references should point to the CN codes that were in force when the Directive was adopted.

Articles 3, 9, 13, 18 and 21 describe how the excise duty is established. Excise duty levied on beer can be set on the basis of one of two different methods: hectolitres/degree Plato or hectolitres/degrees of actual alcoholic strength by volume. Member States which levy the duty by reference to the number of hectolitres/degrees Plato may divide beer into categories of degree and apply different rates to each of these categories (Article 3.2). Excise duty on wine, other fermented beverages and intermediate products is fixed by reference to the number of hectolitres of finished product, while the excise duty on spirits is calculated per hectolitre of pure alcohol.

By setting out definitions of alcohol and alcoholic beverages that apply to all of the EU Member States and also providing clear indications regarding how the excise duties are to be calculated, the Directive defines those products to which excise duties apply. These provisions are closely linked to Directive 92/84/EEC, which indicates the minimum excise duty rates that must be applied to the different product categories. This provides the economic operators with certainty, as they are aware of which products will be subject to excise duty in all the Member States.

## 2.1 Summary of findings

**The current system of classification of alcoholic beverages for excise purposes allows the Member States to use their national excise policies to pursue a multi-dimensional set of policy goals which include both economic and health objectives**. Overall, the provisions concerned continue to meet the needs which they originally set out to fulfil. In the vast majority of cases (in terms both of the absolute number of products and of volumes), the classification of alcoholic beverages and the assignment of products to the various excise categories is straightforward and causes no difficulties either for Member States or for mainstream alcoholic beverages (i.e. the most-consumed ones). The Directive lays down the scope of application of excise duty, provides a comprehensive and clear classification of products and allows for uniform treatment of similar products across the EU.

**Systemic weaknesses of the provisions were identified, in particular with respect to the completeness of the available product categories, legal certainty and clarity of classification in the context of technological and market developments. The issues lead to negative consequences for Member States and economic operators.** The existence of tax incentives that result from having one's product classified under one excise category rather than another has led to the

development and marketing of products which seek to comply with the requirements of a more beneficial tax category while arguably (i.e. in the opinion of the Member States' tax administrations and some competitors) circumventing the intention of the legislator regarding which products should fall into the more favourable category. Lacking clarity of the Directive renders this approach possible.

**Problems primarily concern the category of "other fermented beverages"**. It is disputed which products are intended to fall within this category, (thereby benefiting from a beneficial taxation regime) and which products should be covered by the categories of "intermediate products" or "ethyl alcohol" with a higher excise duty rate. This is not completely clear in the legislation. It is a message which is, arguably, better conveyed, understood and (mainly) accepted in relation to the categories of "beer" and "wine"[14]. Specifically concerned are:

- "Ready-to-drink" products (also known as "alcopops)[15]
- Medium strength fermented beverages between 10-15% ABV[16]
- Fermented alcohol with an alcoholic strength between 15 and 18% reached through industrial processes, bottled and sold to look like its equivalent, higher rate spirit.

**Disputes relating to the classification of certain alcoholic beverages have consequences for excise revenue, legal clarity and the stability of taxation, as well as for the fairness of the competition being experienced by some economic operators.** The high costs for stakeholders identified in the evaluation are not a consequence of the application of systematic obligations inscribed in the legislation; rather, they are the result of the complications and disputes arising from situations in which the stakeholders disagree on the correct interpretation of the provisions of the Directive.

**The current provisions do not fully protect the financial interests of the Member States in relation to the collection of excise duty revenue.** Although research indicates that the quantities of products termed "difficult to classify" remains low, the issue of classification of these product types is potentially a material one, which could result in non-trivial impacts on tax revenues if these products were to be classified differently. The impacts are especially large with spirit-based RTD (ready-to-drink) products and high-strength premixes, where the Member States can opt for the generally much higher ethyl alcohol tax rate. The effect is particularly pronounced in Germany, where the consumption of these products has grown substantially in recent years.

**There is significant added value of establishing common definitions of alcohol and alcoholic beverages for excise purposes at the EU level.** Despite a number of difficulties, no alternative national, bilateral or other international initiative would provide the same level of effectiveness in terms of the functioning of the internal market, or of the monitoring and control[17] of excisable alcohol. It is clear from the unequivocal support for EU-based action by the stakeholders that the common definitions of alcohol and alcoholic beverages for excise purposes should be established at the EU level, as is currently done.

## 2.2 Relevance of common EU definitions of alcohol and alcoholic beverages for excise purposes

In this sub-section we analyse the evidence regarding the relevance of the common definitions of alcohol and alcoholic beverages contained in Directive 92/83/EEC.

[14] Despite the small number of cases, examples of products "difficult to classify" can be found within these categories as well.
[15] Products difficult to classify may represent a *sub-set (i.e. not all) of this category*
[16] Products difficult to classify may represent a *sub-set (i.e. not all) of this category*
[17] See the conclusions on EU Added Value of the EMCS contained in the Evaluation of current arrangements for the holding and moving of excise goods under excise duty suspension (page 62), available at http://bookshop.europa.eu/en/evaluation-of-current-arrangements-for-the-holding-and-moving-of-excise-goods-under-excise-duty-suspension-pbKP0215865/

With common EU definitions of alcohol and alcoholic beverages for excise purposes, the Directive aims to create a clear and consistent framework for the calculation and collection of excise duty which ensures that similar products are treated the same way across the EU. This **objective continues to be of high relevance** for the internal market.

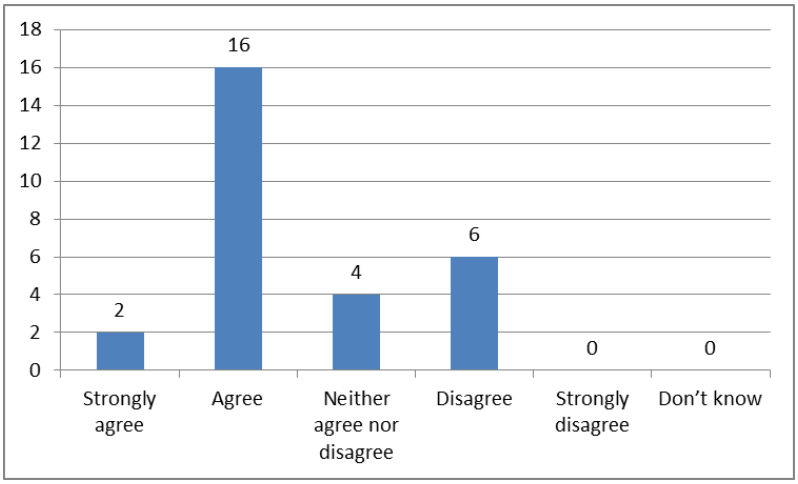
Overall, Member States and economic operators agreed that their needs in terms of classification of alcohol and alcoholic beverages were met. This shows that the provisions are of continued relevance. However, they also reported a number of weaknesses of the provisions with respect to completeness of the classification and its legal certainty. As the technology for production and the market of alcoholic beverages has developed, the **product categories are no longer judged to be unambiguous**.

A majority of the Member States (16) indicated that their needs in terms of the classification of alcohol and alcoholic beverages for excise purposes were being met by the provisions of the Directive. Only six of the Member States[18] reported that the Directive did not correspond to their needs.

The main issue for these Member States was that the classification provided by the Directive is ambiguous. Additional factors mentioned by Member States as reasons for finding the current definitions inappropriate included the fact that the references to CN codes contained in the Directive are no longer up-to-date, issues connected with the classification of mixtures of fermented or cleaned-up alcohol, and a continued reliance on the European Court of Justice's (ECJ) rulings.

Among those Member States[19] that indicated "neither agree nor disagree", one would prefer consistency of taxation based on alcohol content[20] without different categories, while another noted that its excise classification aims to support policy decisions that encourage consumption of one alcoholic beverage over another.

**Figure 2:** ***The needs of my administration in terms of the classification of alcohol and alcoholic beverages for excise purposes are being met by the provisions of the Directive***




*Source: Survey to Member States*

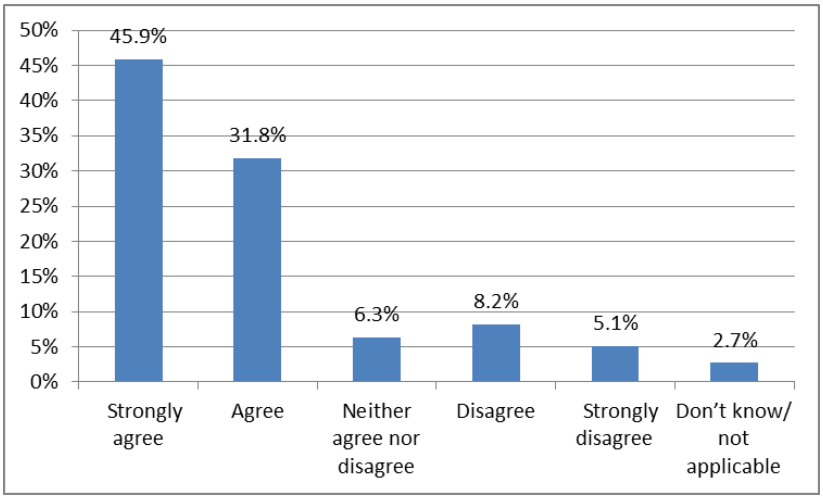
Furthermore, while a large majority of the Member States (21 out of 28) considered that the Directive includes all the product categories needed for classifying alcoholic beverages subject to excise duty, seven Member States[21] indicated that the Directive is incomplete, suggesting the need for the introduction of the following categories:

[18] EE, FI, IE, NL, PL, UK
[19] DE, FR, HU, MT
[20] See Section 8 for additional comments regarding this position
[21] ES, FR, LU, MT, PL, PT, SK

- RTD products (alcopops), or, more generally, products containing "cleaned-up"[22] alcohol (six Member States)
- Products containing mixtures of alcohol of fermented and distilled origin (four Member States)
- Beverages with a high alcoholic strength which contain products in solution (one Member State).

A similar picture emerges when analysing the overall views of economic operators: A large majority of the respondents (strongly) agreed that the classification of alcoholic beverages for excise purposes in the **Directive corresponded to the needs of their industry**. Less than 15% of economic operators indicated that their needs were not being met.

**Figure 3: *Overall, the classification of alcohol and alcoholic beverages for excise purposes corresponds to the needs of the industry in which I operate*. (N=255)**

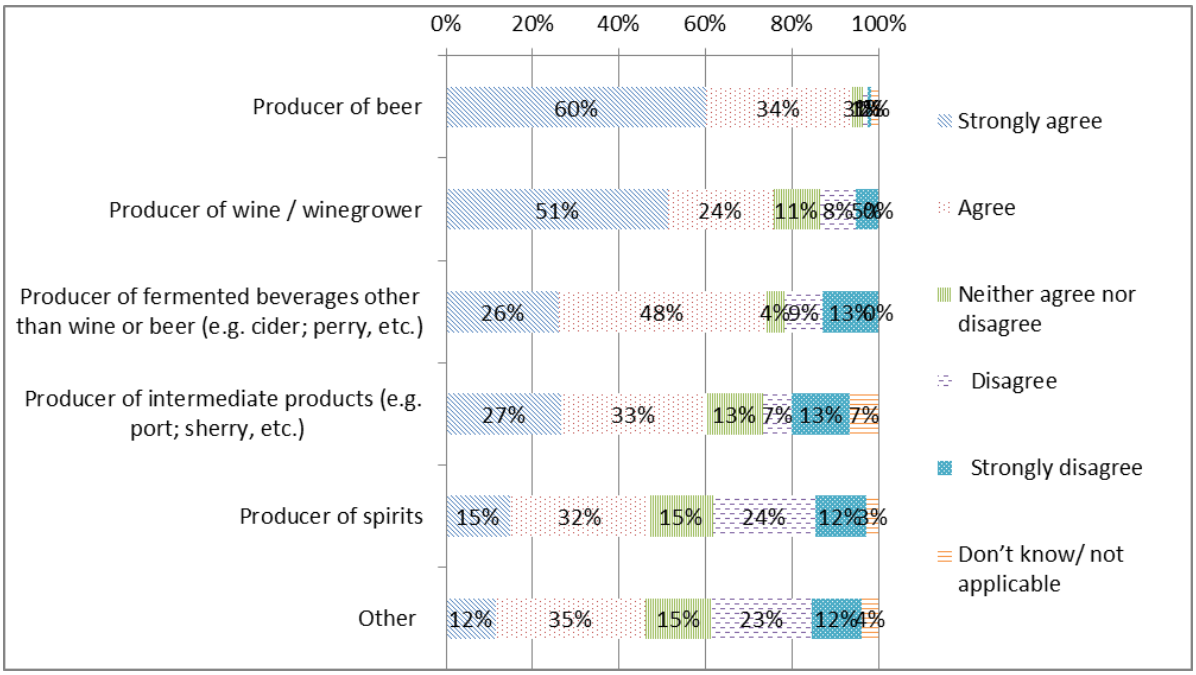



*Source: Survey to economic operators, August-November 2015.*

As Figure 4 shows, an analysis of the responses to the question as to whether the needs of the industry are being met by the classification in the Directive shows that in general, **beer producers were the most satisfied,** while **spirits producers** and "others" indicated that their **needs were not being met**. An analysis of the open-ended answers provided by spirits producers shows that this industry is the most dissatisfied with the system of creating differentiated categories for excise products, and would favour the equal treatment of all alcohol products on the basis of alcoholic strength.

[22] Fermented alcohol which has been subjected to industrial processes that strip out the components which give the liquor its fermented character

**Figure 4: *Overall, the classification of alcohol and alcoholic beverages for excise purposes corresponds to the needs of the industry in which I operate*[23]**




*Source: Survey to economic operators, August-November 2015.*

The analysis of the trade associations' responses to the same question shows that they are slightly more critical, possibly because they are representing a number of different interests. While 12% of economic operators (strongly) disagreed that their needs were being met, the same response was given by 18% of the trade associations. In total, 30% of the associations representing producers of wine and 36% of those representing producers of other fermented beverages indicated that the classification does not correspond to their needs. They were primarily concerned about products of different quality in terms of ingredients were covered by the same category.

Those survey participants who indicated (strong) disagreement were asked to explain why they were of the opinion that the classification was not meeting the needs of their industry. Similarly to the views expressed by the Member States, their chief criticism was that the classification in the **Directive was too complex**, and that it was **difficult to classify products**[24]; however, a different group of respondents (in particular, producers of spirits and the associations representing them) noted that they were dissatisfied with the classification in the Directive because it led to competitive distortions and they consequently argued that uniform taxation on the basis of alcoholic strength is more appropriate.

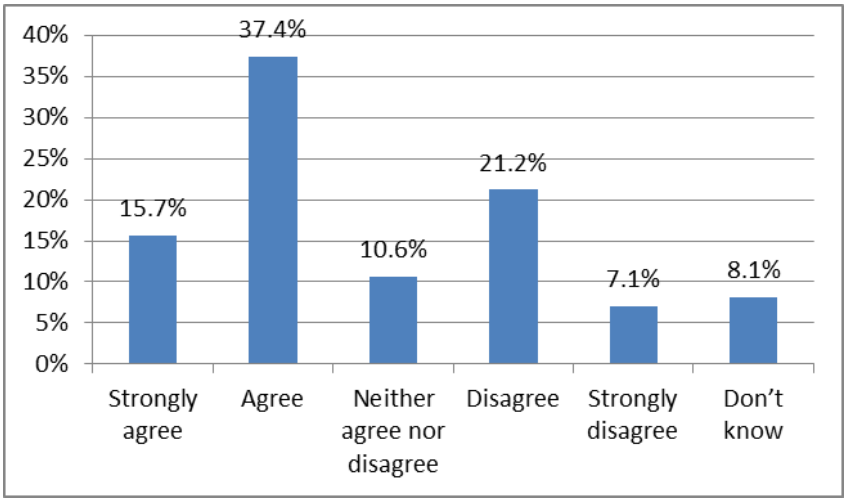
More than half of the respondents to the open public consultation (strongly) agreed that under the current classification system, the **consumer has enough information about what types of alcohol they are buying and consuming**. These were primarily respondents from the private sector (companies of different size) and citizens but also respondents from all other categories agreed. They asserted that for consumers, the alcoholic strength is the most important information on the packaging. Where necessary, consumers are able to find further information online.

[23] Excluding trade associations; N=199. Note: The data labels indicate the relative share of respondents.

[24] As a consequence of the classification issues, respondents noted that producers and distributors of the products concerned (in particular, fortified and/or flavoured fermented beverages) reported experiencing uncertainties about the level of excise duty applicable, which exposed them to significant business risks. At the same time, these classification issues would also represent additional administrative costs.

The 28% of respondents who (strongly) disagreed with the statement were mainly citizens, non-governmental organisations (NGOs) and small and medium-sized enterprises (SMEs). They indicated that **consumers would need more information than only the alcoholic strength**. They also mentioned that there were several products on the market with misleading names or descriptions. Other respondents remarked that there was a clear problem with consumer information, but that this was not linked to the product categorisation provided by the Directive.

**Figure 5:** ***Given the current classification system, the consumer has enough information about what types of alcohol they are buying and consuming*** **(N=198)**




*Source: Open public consultation, August-November 2015.*

The origin and consequences of the identified issues are further discussed in the following section.

## 2.3 Effectiveness - To what extent do the classification rules ensure the functioning of the internal market?

This section assesses the effectiveness of the classification rules with regard to ensuring a proper functioning of the internal market.

By establishing different categories of products, the Directive acknowledges the intention of the legislator to permit Member States to apply differentiated excise duties to these categories when pursuing national alcohol taxation policies.

While some Member States, through the setting of their own national excise rates, have moved closer to a policy of equivalence of taxation of alcoholic beverages, most Member States apply a taxation policy which sets different excise rates for the various groups of alcoholic beverage established by the Directive. We interpret this approach towards alcohol tax policy as being one which pursues multiple objectives.

While they ensure that as a general rule[25] all alcoholic beverages are currently subject to excise duty, the taxation policies of the **Member States tend to offer a preferential tax regime to certain products** in order to preserve or encourage their **socio-cultural aspects** (e.g. the continuous production and consumption of traditional products that are often made from natural ingredients grown in a particular location) and/or to **support the generation or preservation of jobs, practices and traditional crafts**. As a result, the current excise policies of Member States tax some alcoholic beverages more heavily than others.

[25] Exemptions are in place for beer, wine and other fermented beverages for own consumption (Articles 6, 10 and 14), plus a zero rate for wine in some Member States.

The existence of a **tax incentive** to have one's products fall into one tax category rather than another may lead to situations where the stakeholders (Member State authorities as well as economic operators) disagree over whether a particular excise classification is in line with the intent of the excise duty legislation. Regardless, a coherent understanding and application of these categories across the EU is an essential single market objective and an explicit objective of Directive 92/83/EEC.

### 2.3.1 Stakeholders' perception

The consultation of stakeholders in the context of this evaluation revealed that **classification was a widespread problem**: 18 Member States[26] and 23% of economic operators reported difficulties with assigning products to the categories specified in the Directive, while 43% of the respondents to the open public consultation (citizens as well as companies) reported that they had seen or purchased alcoholic products which were packaged to look like their equivalent higher-strength spirits, but were lower-priced. Moreover, in the context of the open public consultation, a quarter of the respondents (all types of respondents) noted that they could give examples of drinks whose classification was not immediately obvious, and how they compared in terms of price to similar products[27].

Additionally, 11 out of 28 Member States[28] noted inconsistencies between the product classification used in the Directive and the customs CN code system, which led to problems. A basic problem noted by three of the Member States was the outdated CN references included in the Directive, as well as a range of other minor inconsistencies. These are reported in detail in Section 7.2.

### 2.3.2 Products difficult to classify

In order to better understand which alcoholic beverages potentially fall into several product categories of the Directive, an in depth case study was conducted (see Appendix 6a - *In-depth case study on classification issues*). The sources and consequences of problems with classification have been assessed. The following section provides an overview of the main findings.

Concretely, the in-depth research conducted has identified certain **products which are "difficult to classify"** that belong to the following product groups:

- RTD products (also known as "alcopops")[29]
- Medium-strength fermented beverages between 10-15% alcohol by volume (ABV)[30]
- Fermented alcohol pushed to 15-21% industrially, bottled and sold to look like its equivalent, higher rate spirit
- Other, less common issues with further products (e.g. wine to which flavours containing alcohol have been added; beer to which alcohol of distilled origin is added; sparkling wine; cooking wine which contains additional ingredients other than alcohol).

The main uncertainty is the question whether these products should be classified as "other fermented beverages", "intermediate products" or "ethyl alcohol". Without attempting to analyse the "correct" legal interpretation of the customs classification under code CN2206 (which is the subject of past and present case law), it is clear from the analysis of the product examples in this case study that the great majority of difficulties with classifying alcoholic beverages for excise purposes are due to the **linkage between the customs classification and the definition of the excise categories**. Specifically,

[26] BE, BG, DE, DK, EE, FI, FR, HR, HU, IE, IT, LU, MT, NL, PL, PT, RO and UK responded "yes" when asked whether they had encountered problems assigning products to the categories of the Directive (such as "uncertainty within your administration, disputes with economic operators").
[27] Most respondents mentioned products containing mixtures of different categories of alcohol, and also to mixtures of alcohol with non-alcoholic ingredients, in particular added sugar or other sweeteners. Many of them mentioned ready-to-drink mixtures and alcopops. Another group of respondents stated that it was difficult to classify certain national or traditional products.
[28] AT, BG, DE, DK, EL, FR, MT, NL, PL, SK, UK
[29] Products difficult to classify may represent a subset of this category (i.e. not all of it).
[30] Products difficult to classify may represent a subset of this category (i.e. not all of it).

the way in which Article 20 (ethyl alcohol) is currently defined, a classification for customs purposes in CN2206 of a product below 22% alcohol would automatically exclude it from being taxed as "ethyl alcohol". This would result (depending on other variables) in an excise classification of either W200 ("Other Fermented Beverages") or I000 ("Intermediate Beverages"), with immediate consequences for the excise rate applicable and potentially distorting effects on competition.

### 2.3.3 Previous attempts to resolve the classification issues identified

CN 2206 is defined as "*Other fermented beverages (for example cider, perry, mead); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included*". In accordance with the general rules for the interpretation of the CN ("the general rules"), which appear in Part One, Section I A of the CN, "*Mixtures … which cannot be classified by reference to 3(a), shall be classified as if they consisted of the material … which gives them their essential character*".

While the **Siebrand**[31] case sought to clarify[32] that "*the loss of the taste, smell and/or appearance of a beverage produced from a particular fruit or natural product*"[33] would result in a 2208 classification, **the notion of *essential character* is extremely difficult to determine**[34] in practice, and the subjectivity[35] of the determination of organoleptic characteristics **opens the door to litigation and disputes** between the economic operators and the tax administrations. The additional criteria introduced by the same judgement, namely *intended use*, has also been reported by Member States[36] to be problematic to implement in its current form, being criticised for its lack of precision.

Moreover, the fact that in most countries, customs classification and excise classification are the responsibility of different departments of their national administrations (or are even *de facto* determined in another country using the instrument of the binding tariff information [BTI]) further amplifies the perception of excise administrations that they are unable to exercise control over the implementation of excise duty legislation.

Additionally, the Siebrand case only applied to mixtures of fermented alcohol of distilled origin. The ECJ expanded this argument to cover cleaned-up alcohol of fully fermented origin through its judgement in the **Toorank**[37] case.

[31] Judgement of the Court (Third Chamber) of 7 May 2009. Siebrand BV v Staatssecretaris van Financiën; Case C-150/08
[32] Although a majority of Member States reported that the criteria laid down in the Siebrand case clarified the classification of products containing a mixture of fermented and distilled alcohol, seven Member States (DE, DK, EE, ES, IE, PL, UK) disagreed with this statement.
[33] *"Fermented alcohol-based beverages corresponding originally to heading 2206 of the Combined Nomenclature in Annex I to Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff, as amended by Commission Regulation (EEC) No 2587/91 of 26 July 1991, to which a certain proportion of distilled alcohol, water, sugar syrup, aromas, colourings and, in some cases, a cream base have been added, resulting in the loss of the taste, smell and/or appearance of a beverage produced from a particular fruit or natural product, do not come under heading 2206 of the Combined Nomenclature but rather under heading 2208 thereof."*
[34] Tax authorities reported in the context of the stakeholder consultation that ten Member States (DE, DK, EE, ES, FR, IE, IT MT, PL, UK) had difficulties defining the 'essential character' of a product for the purpose of deciding its classification.
[35] More than half of the economic operators responding to the survey reported that they considered that the criteria laid down in the Siebrand case had clarified the classification of products containing a mixture of fermented and distilled products. Nevertheless, 11.9% of the economic operators (strongly) disagreed that the Siebrand criteria had helped with this classification. In the context of the open consultation, one fifth of the respondents indicated that classification problems were not reduced by the judgement. These participants suggested that there remained too much room for interpretation of the terms used by the ECJ, and that the judgement was not precise enough to allow for a clear and consistent classification.
[36] Seven Member States (BG, DE, EE, ES, MT, PL UK) were experiencing difficulties with the definition of "*intended use".*
[37] Joined Cases C-532/14 and C-533/14, Judgement of the court of 12 May 2016, available at: http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d2dc30d5d13eaa9703c04c2e89f4eb3d2efaf410.e34KaxiLc3qMb40Rch0SaxuTahb0?text=&docid=178161&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=874565

These legalistic attempts to resolve the classification issues, which only take account of the literal application and interpretation of the provisions, are directly indicative of the Directive's lack of clarity. As necessary as these cases have been for determining the correct legal interpretation of the applicable legislation on a case-by-case basis, they do not fully resolve the core issue at stake, namely that the **nature, purpose and objective of the excise category of "other fermented alcohol" is not clear** to (and therefore, not fully accepted by) all the stakeholders involved.

## 2.4 Effectiveness - Impact of potential classification issues on taxation revenues

This section summarises findings with regard to the impact of classification issues on taxation revenues. The complete analysis can be found in Appendix 6b – *In-depth case study on classification issues – quantification*.

In order to quantify the potential impact of the classification issues on taxation revenues, granular data on prices and volumes for the product groups in question have been reviewed. The quantitative exercise was restricted by the data availability and product groups contained in the Euromonitor database. The analysis was focused on the following Euromonitor categories: **"Wine-based RTDs"; "Spirit-based RTDs"; and "High-strength premixes"**. (Full details of the quantification exercise can be found in Appendix 6b – *In-depth case study on classification issues – quantification*.)

Using the evidence from the stakeholder consultation, we have identified the following as possibly being relevant for the taxation of the products identified:[38]

- Wine-based RTDs: "Other fermented beverages" or "Intermediate products";
- Spirit-based RTDs: "Other fermented beverages" or "Ethyl alcohol";
- High-strength premixes: "Intermediate products" or "Ethyl alcohol".

Given the current product definitions provided in the Directive, it is not possible to say with certainty that one of the tax categories identified above is correct. We have therefore considered the effects of moving these products from one category across to the other in two different taxation scenarios:

**Table 4: Taxation scenarios for analysis**

| | Scenario 1 | Scenario 2 |
|---|---|---|
| Wine-based RTDs | Other fermented beverages → Intermediate products | Intermediate products → Other fermented beverages |
| Spirit-based RTDs | Other fermented beverages →Ethyl alcohol | Ethyl alcohol → Other fermented beverages |
| High-strength premixes | Intermediate products → Ethyl alcohol | Ethyl alcohol → Intermediate products |

These scenarios underpin our estimates of the price changes that might result for each of these product categories as a consequence of a classification change. Using Euromonitor data on the prices and volumes sold for these product groups, plus our assumptions regarding the extent to which a change in taxation would result in price changes for final consumers and the consumers' price elasticity of demand for these types of alcoholic product, we were able to estimate the impact of the potential classification issues on the taxation revenues associated with these product groups that are deemed to be difficult to classify – in other words, their impact on the tax revenues that would be at stake if these products had been classified differently.

[38] In addition, in the case study we also consider using the national tax in place in France for RTDs as the baseline taxation and the impacts of moving to alternative classifications.

We stress that the results of this quantitative exercise are purely indicative, and are based on scenarios that were developed using the results of the stakeholder engagement with Member States and economic operators. Specifically, to illustrate the potential impact on tax revenues, we look at scenarios in which total volumes of a particular product group are taxed under one category (e.g. fermented beverages) and are then moved to another category (e.g. intermediate products) — and *vice versa*.
The responses to the stakeholder consultation suggest that, in some instances, a certain classification for tax purposes is currently being applied in practice, but that an alternative classification could be applied. Where this is the case, in the tables below we have highlighted what appears to be the current scenario (i.e. the base case) in bold, as this reflects the scenario that is more likely in that Member State. Where it is not clear what taxation treatment is currently being applied, the estimates for both scenarios are presented in bold.

Our approach implicitly assumes that Member States adopt a clear, strict approach to the taxation of these products (e.g. by successfully identifying all spirit-based RTDs and taxing them using the ethyl alcohol rate). In reality, it may be that the tax treatment applied by any given Member State to those products within any of the Euromonitor-defined product groups is inconsistent. Certain products could still prove to be difficult to classify, or certain products could be "missed" as Member States are unaware of the specific details of the product. This can be seen as inherent in the nature of the problem. As a result, in practice there would most likely continue to be multiple possible classifications. It follows that the potential tax impacts presented below (which are based on total volumes being taxed under one category and being moved to another category) are likely to overestimate the potential impact. Nonetheless, this exercise represents the best estimates that can feasibly be quantified.

Our analysis suggests that the **tax impacts associated with alternative classification of wine-based RTD's are likely to be minimal** in absolute terms, largely due to the relatively small difference between excise duty rates for other fermented beverages and intermediate products.

**Table 5: Tax impact of classifying wine-based RTDs as other fermented beverages or intermediate products**

| | Scenario 1 (Other fermented beverages → Intermediate products) | | Scenario 2 (Intermediate products → Other fermented beverages) | |
|---|---|---|---|---|
| | Min tax in €m/year | Max tax in €m/year | Min tax in €m/year | Max tax in €m/year |
| **France** | **14** | **16** | **-16** | **-16** |
| **Germany** | **50** | **61** | **-62** | **-57** |
| **Ireland** | **3** | **4** | **-5** | **-4** |

*Source: Europe Economics estimates*

The **potential impacts of the alternative classification of spirit-based RTDs are much larger**. In relative terms, the greatest tax change would be seen in France. However, as can be seen in the table below, in absolute terms the impact is relatively small when compared to other countries. This is worth noting, as it is the combination of volumes, prices and tax changes in absolute terms that determines the overall impact, and Euromonitor records the volume of spirit-based RTDs sold in France as being quite low. This explains why we see such large potential impacts in Ireland, because the difference in taxation between other fermented beverages and ethyl alcohol in Ireland is extremely large in absolute terms (and the volume of spirits-based RTDs consumed in Ireland is quite large, considering the small population of the country).

**Table 6: Tax impact of classifying spirit-based RTDs as other fermented beverages or ethyl alcohol**

| | Scenario 1 (Other fermented beverages → Ethyl alcohol) | | Scenario 2 (Ethyl alcohol → Other fermented beverages) | |
|---|---|---|---|---|
| | Min tax in €m/year | Max tax in €m/year | Min tax in | Min tax in €m/year |
| **Poland** | 116 | 127 | **-128** | **-128** |
| **France** | 60 | 67 | **-67** | **-67** |
| **Germany** | 190 | 200 | **-201** | **-200** |
| **Ireland** | -169 | 185 | **-185** | **-185** |
| **Netherlands** | **102** | **110** | **-110** | **-110** |

*Source: Europe Economics estimations*

Finally, the table below presents the **potential impacts associated with the alternative classification of high-strength premixes**. Here, the potential impact in Ireland is very small because of the low level of consumption of high-strength premixes in Ireland (despite the large difference in taxation in absolute terms between intermediate products and ethyl alcohol in Ireland). However, much larger impacts might be seen in Germany, where consumption of these types of product is relatively high, and the difference in tax between the two categories is also quite large.

**Table 7: Tax impact of classification of high-strength premixes as intermediate products or ethyl alcohol**

| | Scenario 1 (Intermediate products → Ethyl alcohol) | | Scenario 2 (Ethyl alcohol → Intermediate products) | |
|---|---|---|---|---|
| | Min tax in €m/year | Max tax in €m/year | Min tax in €m/year | Max tax in €m/year |
| **France** | **115** | **124** | **-125** | **-124** |
| **Germany** | 214 | 225 | **-225** | **-224** |
| **Ireland** | 4 | 4 | **-4** | **-4** |
| **Netherlands** | **91** | **92** | **-92** | **-92** |

*Source: Europe Economics estimations*

## 2.5 What is the scope for the reduction of administrative burdens and compliance costs?

This section assesses the efficiency of the classification rules. It highlights where administrative burdens and compliance costs could be avoided.

Although the classification of most alcoholic beverages from an excise perspective is generally straightforward and results in little to no administrative burden (due to the fact that normally, classification is not felt to be particularly time-consuming by the relevant stakeholders), the research conducted in the context of this evaluation reveals that issues surrounding the classification of products which have been identified as "difficult to classify" result in increased costs for all the stakeholders concerned (i.e. for the Member States' tax authorities as well as for economic operators).

The **high costs** identified are not a result of the application of systematic obligations inscribed in legislation; rather, they are the **result of the complications and disputes** arising from situations in which the stakeholders disagree on the correct interpretation of the provisions of the Directive. The costs implied for each organisation will vary significantly depending on the evolution of a given case, the economic importance of the disputes, the willingness of the parties to settle the matter via the judicial system, etc. Both the number of cases and their geographical extent indicate that these complications are the result of the Directive's failure to provide the stakeholders with adequate clarity.

Although a precise monetary quantification of the expected cost reductions has not been possible due to the varied nature of the cases reported, the research conducted during this study confirms that **effective measures to resolve difficulties in classifying**

alcoholic beverages for excise purposes **would reduce administrative costs** both for the Member States' administrations and for the economic operators involved.

Difficulties in classifying alcoholic beverages for excise purposes can have **multiple types of impact** on stakeholders, including:

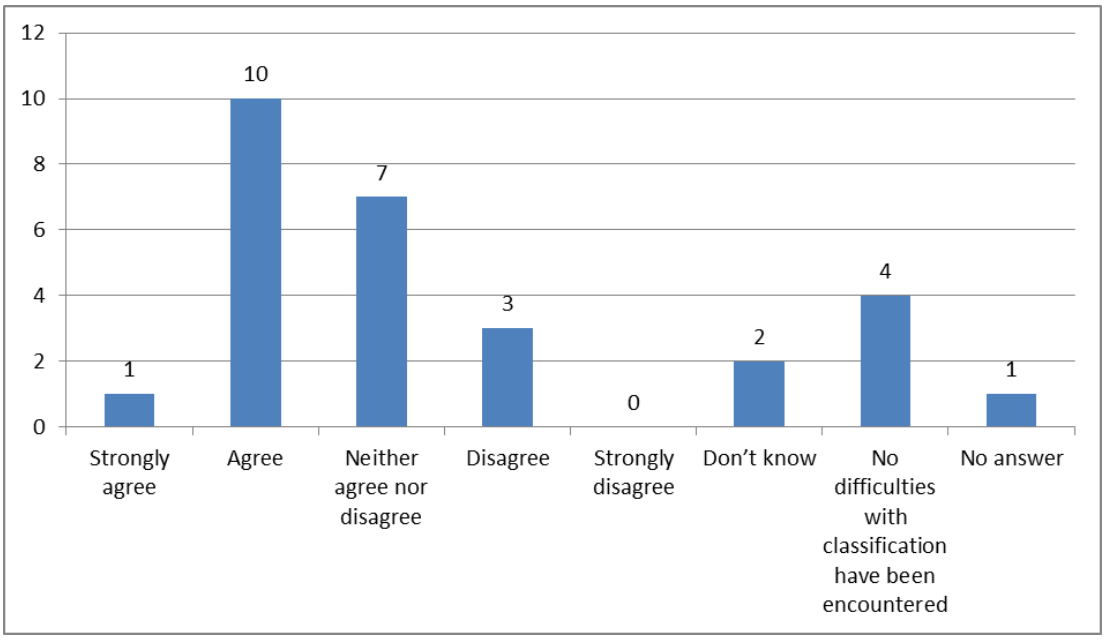
- Differences in the level of taxation;
- Difficulties in operating across borders (e.g. due to uncertainty or regulatory barriers);
- Competitive distortions;
- Increased administrative burdens and compliance costs.

The section above has comprehensively covered the potential impact on taxation revenue associated with potential classification issues, while details regarding the second and third bullet points (based on individual accounts related to specific products) can be found in the case study report on classification (see Appendix 6a - *In-depth case study on classification issues* and Appendix 6b – *In-depth case study on classification issues – quantification*). This section contains information on the consequences both for Member State authorities and for economic operators in terms of increased administrative burdens and compliance costs.

As can be seen from Figure 6, eleven Member States[39] agreed or strongly agreed that the difficulties encountered with the classification of alcohol and alcoholic beverages were leading to increased administrative costs. One Member State in particular (FR) emphasised that uncertainties linked to the classification can generate costly situations for its administration both in terms of working hours and the costs linked to the classification procedure and the laboratory analysis of products.

> *"The dispute on the classification with the producer of a product of fermented base which has been elaborated to resemble distilled alcohol requires nine employees of the tax and customs authorities to be involved."*
>
> French tax authorities

**Figure 6:** ***The difficulties encountered with the classification of alcohol and alcoholic beverages lead to increased administrative costs***




*Source: Survey to Member States*

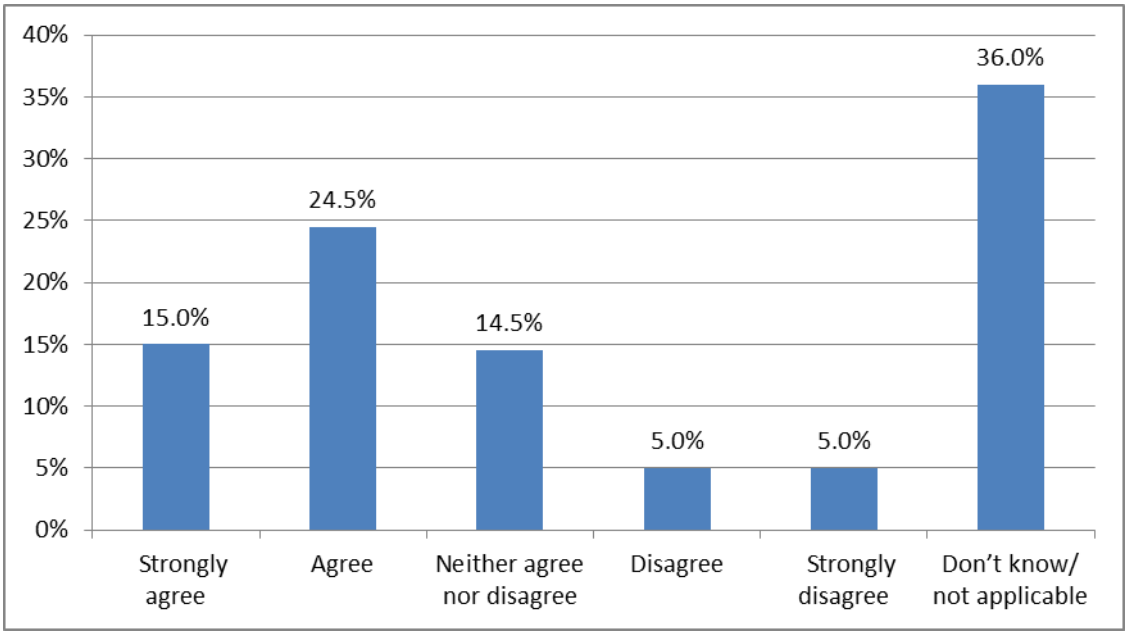
[39] Seven Member States neither agreed nor disagreed, only three Member States disagreed (AT, ES, LT), and a further four (CY, EL, LU, SI) reported not encountering any difficulties in the first place.

None of the eleven Member States which considered that classification issues were affecting administrative costs, were able to specify precisely to what extent their administrative costs were greater than they would have been otherwise.

As can be seen in Figure 7 and Figure 8, 29.5% of the responding economic operators who reported that they had had difficulties with the assignment of alcohol and alcoholic beverages to the categories of the Directive indicated that these difficulties had led to increased administrative costs, while only 10% of them stated that this was not the case. While this percentage was the lowest among the beer producers (with a few of them indicating that they (strongly) disagreed that administrative costs were increased by difficulties involving the classification of products), this was not the case for economic operators in the other industry sectors. In all the other sectors, **more than 50% of respondents (strongly) agreed that administrative costs were increased** by the classification issues.

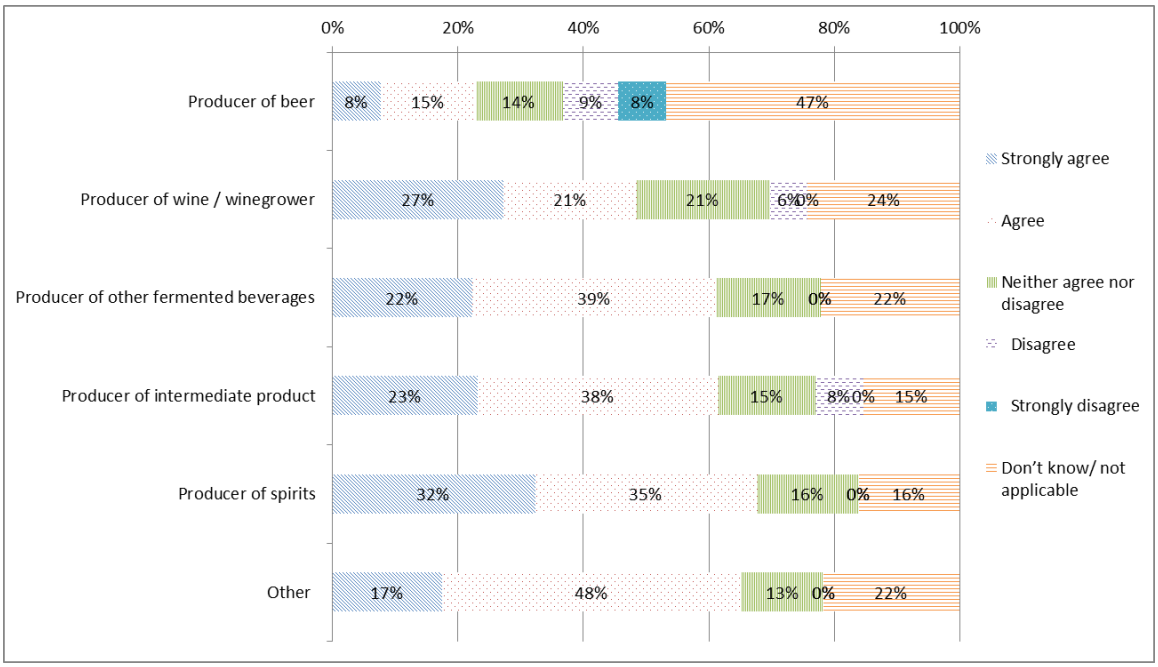
> *"The dispute over the classification of a product of fermented base with added ethyl alcohol has been taken to court. The case lasted for four years."*
>
> Trade association of spirits producers

**Figure 7: *The difficulties encountered with the classification of alcohol and alcoholic beverages lead to increased administrative costs* (N=200)**




*Source: Survey to economic operators, August-November 2015.*

**Figure 8: *The difficulties encountered with the classification of alcohol and alcoholic beverages lead to increased administrative costs*** [40]



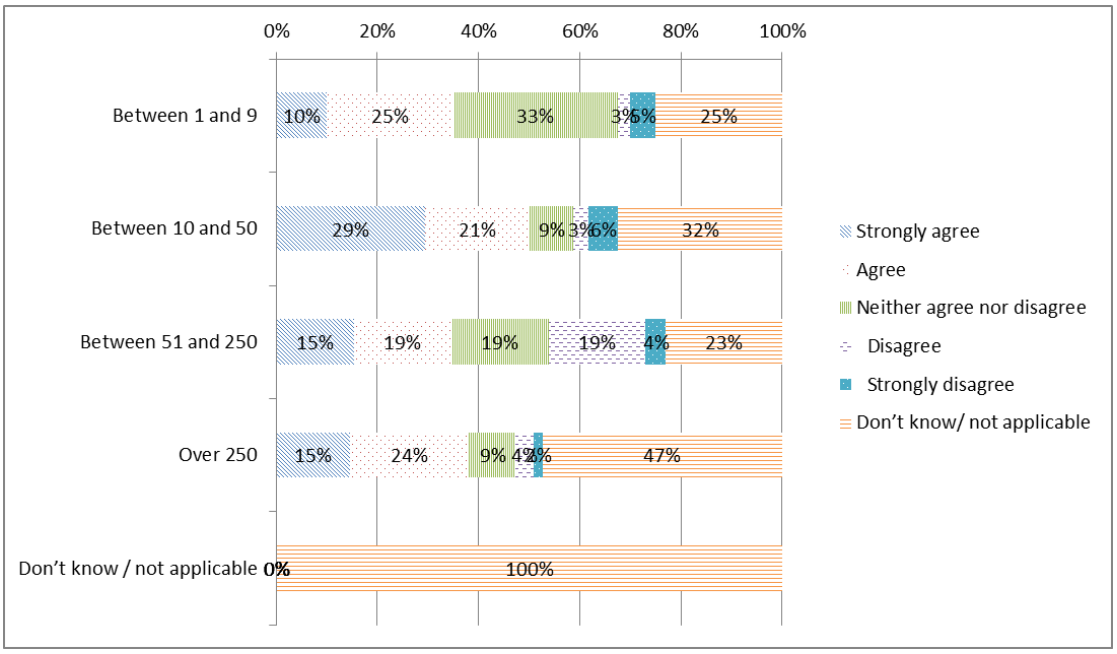

*Source: Survey to economic operators, August-November 2015*

Only five out of 43 trade associations responding to this question did not report that their administrative costs had increased due to classification problems. In particular, trade associations representing spirits producers strongly agreed that administrative costs would be increased.

An analysis of the responses by size of economic operator (represented by the number of employees) shows that medium-sized companies were most concerned about increased administrative costs due to classification difficulties. Half of the companies with 10 to 50 employees reported that they (strongly) agreed that administrative costs had increased due to classification issues. The analysis also showed that **companies of all sizes had experienced increased administrative costs**.

[40] Excluding trade associations; N=157.
Note: the data labels indicate the relative proportions of respondents who gave a particular answer.

**Figure 9:** ***The difficulties encountered with the classification of alcohol and alcoholic beverages are leading to increased administrative costs***[41]




*Source: Survey to economic operators, August-November 2015*

As a result of the overwhelming amount of evidence reported by stakeholders in the context of the surveys, the in-depth case study on classification issues has further investigated the extent to which classification issues are generating increased administrative burdens for stakeholders.

Approximately **70 different cases** of products "difficult to classify", **spanning a majority of Member States,** were reported by stakeholders in the context of the evaluation. While the consequences surrounding each case are unique (some were resolved swiftly following a few exchanges between the tax administration and the economic operator in question, while others became the subject of lengthy court cases spanning several years), it is clear from this research **that all the cases have resulted in additional administrative burdens** for the tax administrations (which have to dedicate additional resources to enforce their view of the correct classification) and compliance costs for economic operators (who would need to undertake similar actions to defend their position against either the tax administration or a competitor).

An important outcome revealed in relation to the situations documented is litigation costs. Disputes between tax administrations and operators are likely to be taken to court, resulting in significant costs both for the administration and for the economic operators if the financial risk at stake is considerable. Additionally, litigation results in significant costs for economic operators seeking to correct the perceived unfair competition presented by "difficult to classify" products. This has been particularly observed in cases when high-strength mixtures emulate or directly compete with spirits or intermediate products which are taxed at a higher rate.

## 2.6 EU added value

The EU added value is understood as the additional gains stemming from acting at the EU level versus a national initiative, a bilateral initiative, or a different type of international

[41] Excluding trade associations; N=157
Note: the economic operators are categorised by size according to the number of employees; the data labels indicate the relative proportions of respondents who gave a particular answer.

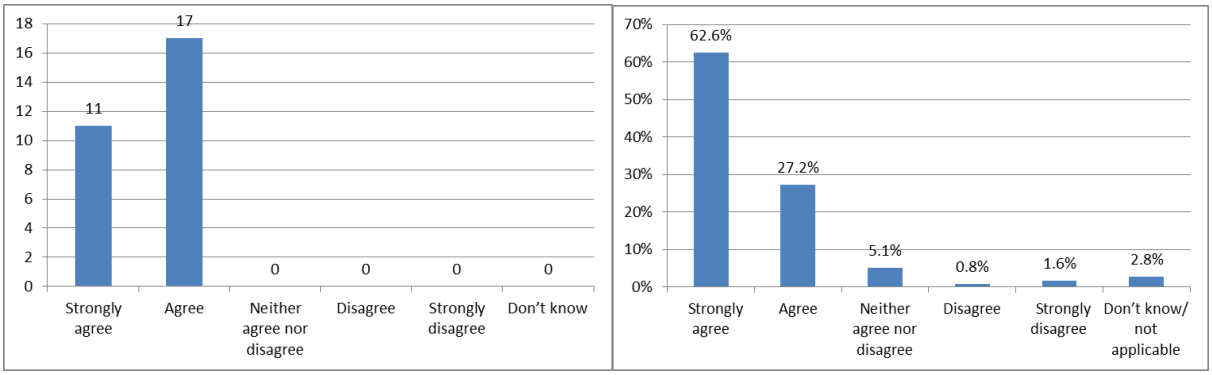
initiative. In this section, the added value of setting classification rules at EU level is assessed.

Despite the shortcomings described above, no alternative national, bilateral or other international initiative would provide the same level of effectiveness in terms of the functioning of the internal market and the monitoring and control[42] of excisable alcohol, and **significant added value** consequently accrues from establishing common definitions of alcohol and alcoholic beverages for excise purposes at the EU level.

Furthermore, the identified issues demand for a stronger EU level approach. Decisions taken unilaterally, such as issued BTIs for certain alcoholic beverages create additional complexity, while a solution that would clarify the scope of the current categories in agreement of all Member States would provide a much more effective solution.

There was strong and broad agreement among all stakeholders consulted on this issue: in particular, all responding Member States and 90% of economic operators either agreed or strongly agreed that **common definitions of alcohol and alcoholic beverages for excise purposes should be set at the EU level**, as is currently done.

**Figure 10: *Common definitions of alcohol and alcoholic beverages for excise purposes should be set at the EU level (as is currently the case*)**




*Sources: Survey to Member States (left) and survey to economic operators[43] (right), August-November 2015*

The main reasons cited by all types of stakeholders were that such an approach is most appropriate for:

- Ensuring the free movement of goods and the uniform treatment for excise purposes of the same products across the Member States
- Providing uniform categories and a common interpretation
- Forming the basis for a harmonised approach to controlling movements and thus avoiding illegal trade
- Reducing administrative costs.

It is clear from the unequivocal support for EU action by stakeholders that the common definitions of alcohol and alcoholic beverages for excise purposes should be set at the EU level, as it is currently.

## 2.7 Potential actions for addressing classification issues

There are multiple possible solutions with which to address the classification issues presented within the context of this study; however, it is clear that none of them can be seen as a "silver bullet" that has the capability to resolve the issues identified without any associated drawbacks. A set of measures which could be considered is described in Table 8 below, together with their relative advantages and disadvantages. A selection of these potential solutions has been further developed in form of recommendations in Chapter 10.

[42] See conclusions on EU Added Value of the EMCS contained in the Evaluation of current arrangements for the holding and moving of excise goods under excise duty suspension (page 62), available at http://bookshop.europa.eu/en/evaluation-of-current-arrangements-for-the-holding-and-moving-of-excise-goods-under-excise-duty-suspension-pbKP0215865/
[43] The number of individual respondents answering this question is 273.

**Table 8: Potential measures for addressing the difficulties in classifying products which may arguably fall between CN codes 2208 and 2206**

| | |
|---|---|
| Member States could **unilaterally revise tax rates and the tax structure** for "other fermented beverages". | At the moment, most Member States apply a similar amount of excise tax both to "other fermented beverages" and to "wine". This is in line with the initial purpose of this category and the fair competition between traditional, "acceptable" products belonging to the "other fermented beverages" classification and those falling under "wine" and "beer". Even the technical specifications of the Excise Movement and Control System (EMCS) do not draw a distinction between the two, whereas W200 applies to both excise categories (an issue which should, arguably, be modified to take the existing different categories into account).<br><br>To solve the dilemmas created by innovative products which it is generally agreed should not benefit from the same preferential treatment, Member States could unilaterally change the rate of excise tax of "other fermented beverages" in order to bring the expected tax due under this category approximately into line with that applying to beverages of similar strength and falling under "ethyl alcohol". Different tax bands could be established to pursue this objective (i.e. between 2.8% and 4%, between 4% and 6%, between 6% and 10%, between 10% and 15%, between 15% and 22%, etc.).<br><br>The most important advantage of this solution is that it could be implemented by the Member States straightaway within the context of the current EU legislative framework. Changes to the taxation rates for "other fermented beverages" can reduce or even eliminate the tax advantage that the products described above have over competitors taxed as "ethyl alcohol" / S200.<br><br>However, there are several disadvantages to this solution: Firstly, and very importantly, it erodes the very rationale for the establishment of the category, which is to target certain products in the "other fermented beverages" category whose taxation should be more in line with that of "beer" / "wine" rather than "ethyl alcohol". This weakness could be partially mitigated by creating additional tax bands for those products which the category is intended to target in this way. For example, certain counties have such bands in place for cider and perry (e.g. IE, PL, RO and the UK). However, such a mitigating action risks excluding certain products, thereby creating further competitive distortions.<br><br>A second disadvantage is that the current specifications of the EMCS lack a category for other fermented beverages, which it groups with wine as W200 in the EMCS system. If Member States move away from an equivalence of taxation between "wine" and "other fermented beverages", an inconsistency in the EMCS would be created that would require correction.<br><br>Finally, instituting such differences within the same excise category may make it difficult to establish adequate guarantees when products of the "other fermented beverages" category are moved under suspension of excise duty, as different Member States may introduce different structures for taxing products within this category. |
| Member States could **apply the notion of "entirely of fermented origin" more strictly.** | Article 17 (2) states that "Member States may treat as intermediate products any still fermented beverage falling within the scope of Article 12(1) which has an alcoholic strength exceeding 5.5% and is not entirely of fermented origin".<br><br>This solution could be implemented immediately and unilaterally in the current EU legislative context. It would avoid classifying some (albeit not all) products falling within the category described above as "other fermented beverages". It would limit the tax advantage of these products to the difference in rates being applied to "intermediate products" and "ethyl alcohol".<br><br>As an extension to this solution, a revision of Directive 92/83/EEC could seek to lower the threshold of 5.5% in order to capture more of the products described above. However, this solution might have unintended consequences for the treatment of certain products which could also be caught by this policy (e.g. wine to which flavours containing alcohol had been added). |

| | |
|---|---|
| Member States could **unilaterally impose an additional excise tax** on ready-to-drink products (alcopops). | This measure is currently applied by France, which imposes a tax of 11 EUR per decilitre of pure alcohol for alcohol beverages mixed with non-alcoholic products or mixes of alcoholic products which have more than 1.2% but less than 12% alcohol.<br><br>Like the solution immediately above, this one has the advantage that it could be implemented by Member States immediately within the context of the current EU legislative framework. The disadvantage is that such a unilateral move could have unintended negative consequences for the proper functioning of the internal market which are impossible to assess accurately in the context of the present study. |
| **Add an additional CN note** to provide clarity as to the correct treatment, for customs purposes, of fermented products which have lost their essential character. | This "additional note" at the 8-digit CN level would cover cleaned-up fermented products, and would require them to be classified as 2208 – (i.e. the 8-digit CN code level). This note would be defined thus: "products having lost the organoleptic characteristics of a fermented beverage should be classified as 2208, independently of alcoholic strength".<br><br>In effect, this solution would seek to make the outcome of the Siebrand case generally applicable, and would make it legally binding by introducing it into law through the mechanism of an additional note. In order to adequately capture all the variables of the issue, the additional note would have to apply both to mixtures of fermented and distilled alcohol (such as Siebrand), and to "cleaned-up" alcohol (i.e. alcohol derived from a fully fermented base, but which has also been subjected to processing that has caused it to lose its essential character as a fermented drink).<br><br>However, this solution does not solve the Member States' difficulties with applying subjective classification criteria (e.g. the determination of organoleptic characteristics), nor does it eliminate the possibility that excise administrations will have to continue to be restricted in their enforcement of excise law by the classifications made by customs authorities (either in their own country or in other countries). Nor does this solution eliminate the need for a revision of Directive 92/83/EEC, as the effectiveness of this solution requires an amendment of Article 26. |
| The Directive could be amended to **include a new category of excise products** that would adequately encompass the products described. | This measure would have the effect of creating a distinct category comprising alcoholic beverages mixed with non-alcoholic products, or mixes of alcoholic products falling under CN 2206, with the aim of establishing legal clarity regarding the treatment of the "difficult to classify" products described in this section. In order to avoid competitive distortions, the structure (and level) of taxation should be in line with that applicable to "ethyl alcohol".<br><br>The disadvantage of this solution is that it would increase the complexity of excise law. For example, it would lead to an inconsistent situation where (all things being equal, and assuming an equivalence of taxation of this new category with that of "ethyl alcohol") in some countries, intermediate products might be taxed less per degree of pure alcohol than products falling into this new category, despite having greater alcoholic strength. |
| **Article 20**, indent 1 of the Directive could be amended to **bring products falling under CN 2206** within its scope. | This solution would allow products falling under CN 2206 for excise purposes to be treated as "ethyl alcohol", thus requiring no changes to customs legislation to resolve what is, arguably, an excise issue. However, such a solution would require an additional amendment to Article 12 of the Directive in the form of clear criteria describing the basis on which a CN2206 product would be considered to be an "other fermented beverage" or "ethyl alcohol". Such a distinction requires the expression of the clear intention of the legislator as to what should be considered fermented beverages for excise purposes.<br><br>An example of such a formulation could be: "products falling under code 2206 that have lost the organoleptic characteristics of a fermented beverage should be classified for excise purposes as "ethyl alcohol", independent of alcoholic strength".<br><br>This solution, however, faces the same practical difficulties connected with assessing the organoleptic characteristics of a fermented beverage. |

| | |
|---|---|
| Introduce the criteria established by **ECJ cases into the Directive.** | This solution would see the criteria that were established in the landmark cases of Siebrand and Toorank (or more operationalised versions of these criteria) being inscribed in the Directive, thereby making them more coherently applicable by ensuring they become legally binding. These criteria would involve making the following considerations for classifying a product as "ethyl alcohol" rather than "other fermented beverage" an integral part of the revised Directive:<br><br>• Organoleptic (i.e. taste, sight, smell) characteristics of the products: If the addition of water and other substances (such as syrup, various aromas and colourings, and, in some cases, a cream base) results in a loss of the taste, smell and appearance of a beverage produced from a particular fruit or natural product (that is to say, a fermented beverage falling under CN code 2206), then the product would fall into the CN code 2208 category, placing it in the "spirits" category for the purposes of excise duty.<br><br>• The intended use of a product: this could comprise an objective classification criterion if the intended use was inherent in the nature of the product. That inherent character must be possible to assess on the basis of the product's objective characteristics and properties, including its form, its colour and the name under which it is marketed. If those correspond to the characteristics of a spirituous beverage, then the product would fall into the CN code 2208 category, placing it in the "spirits" category for the purposes of excise duty.<br><br>This solution would provide clarity for Member States and increase the uniformity of approaches across all the Member States by avoiding the uneven application and enforcement of the ECJ criteria. However, if was not adequately operationalised, this solution would not alleviate the practical difficulties of Member States in applying these notions consistently and comprehensively. |

# 3. Reduced rates for different types of product and producer, and exemptions for private consumption

This section presents the evaluation findings relating to the functioning of these rules. The sub-sections of this chapter attempt to cover all the relevant evaluation criteria. We have assessed whether reduced rates for small producers create any competitive distortions. With limited data available it has not been possible to estimate the tax impact of reduced rates on the Member States.

The Directive allows the Member States to grant reduced rates to certain categories of producer (i.e. small producers and fruit growers) and to certain products (i.e. alcohol beverages below a certain alcoholic strength and products of a regional or traditional nature). It also exempts certain categories of alcoholic beverage produced for own consumption from the scope of excise duty legislation.

## 3.1 Summary of findings

### 3.1.1 Reduced rates for small producers

**The provisions giving the Member States the option to apply reduced rates to small breweries and distilleries are overall found to be of continued relevance.** As they ensure a uniform approach to reductions, they enhance the approximation of national excise duty rates while avoiding distortion of competition between the Member States.

**In general, reduced rates for small producers are not having a detrimental impact on competition**[44]. On the contrary, reduced rates help level the playing field to a certain extent; however, the fact that firms qualifying for reduced rates generally account for a very small proportion of the market is suggestive of gains pf larger producers from economies of scale being sufficiently large so as to outweigh the gains to small producers from reduced rates.

**No evidence was found that the threshold for reduced rates for small breweries would create competitive disruptions.** Some Member States expressed discontent with what they considered an excessively high threshold at which the reduced rates for small-scale beer producers kicked in. However the evaluation identified no negative effects of reduced rates which means that the interests of those Member States that are not providing the reduced rates at the maximum threshold suggested in the Directive are not being affected by the choices made by other Member States.

**Overall, both Member States and economic operators were interested in extending the reduced rates to still and sparkling wines, other fermented beverages and intermediate products; no negative impact on competition is expected.** A particular focus lies here on the potential for distortions in the cider market due to the absence of reduced rates for small cider producers and the claimed substitutability of beer and cider. From our analysis of competition, it seems unlikely that the presence of reduced rates for small brewers and small distilleries would create competitive distortions in these other markets. However, to the extent that the rationale for the reduced rates holds for small brewers and distillers, i.e. to level the playing field and allow small producers of these products to compete more effectively against larger producers, it may be appropriate to extend this rationale to producers of other beverages, as economies of scale are likely to be present in those sectors as well.

[44] The volume of beer and ethyl alcohol being produced in the Member States which apply the provisions likely to benefit from reduced rates is sufficiently small so as to be unlikely to result in any distortions in competition — within markets (e.g. beer produced by small brewers vs. beer produced by large brewers), across markets receiving reduced rates (e.g. beer produced by small brewers vs. spirits produced by small producers subject to tougher qualifying thresholds), or across all markets (e.g. beer produced by small producers vs. other fermented beverages not subject to any reduction in rates)

**Surprisingly, small producers of wine and other fermented beverages were overall opposing the introduction of reduced rates for small producers**. A potential explanation for this position could be the fear of such stakeholders that the introduction of such a reduced rate would result in some Member States abandoning the current zero rate they apply to wine in favour of a more nuanced excise tax policy; alternatively, such a position could be explained simply by the lack of a need among these stakeholders for additional reduced rates, especially in the context of the exemptions of small wine producers from the scope of application of the mechanism for monitoring and control under Article 40 of Directive 2008/118/EC..

**The threshold for the application of reduced rates for small producers for ethyl alcohol is assessed as being too low to generate any sizeable impact on the producers of spirits.** However, some Member States argued that the effect of an increase in this limit would incentivise the consumption of products with a high(er) alcohol content; this is an objective which is not coherent with other policy objectives, including those pursued by certain provisions of the Directive (e.g. reduced rates for products with low alcohol content).

### 3.1.2 Reduced rates for low-strength alcoholic products

**The lack of a clear rationale for providing Member States with the possibility to apply reduced rates for low strength alcoholic products may negatively influence the use of these provisions.** The stated purpose of the Directive that sets common upper limits at the EU level below which reduced rates can be introduced by Member States is to protect internal market objectives. However, at the level of their implementation (i.e. at the level at which they are adopted and put into practice by Member States), the introduction of reduced rates for alcoholic beverages below a certain alcoholic strength is intended to encourage the production and consumption of lower-strength beverages within each category. The Directive does not explicitly state that these provisions are to be seen as a tool for pursuing health policy objectives[45]. This may negatively affect their uptake by Member States, the adequacy of their implementation nationally and the level of support they receive from the public and industry.

**These reduced rates are largely accepted as appropriate by stakeholders.** They are however used to varying extend in the Member States and are linked to several weaknesses:

- **One Member State has expressed its desire to increase the threshold for the application of reduced rates for low-strength beer**; It was not possible to determine the extent to which any positive effects would be observable as a result of promoting healthier alternatives, nor whether such a change might result in negative competitive consequences (either within the national market where it would be implemented, or at the level of the internal market).
- **The reduced rate for wine of low strength is only applicable to very few products.** The widespread zero rates for wine, together with the rigid EU and international agricultural and commercial standards which are applicable in the wine industry, render the 8.5% threshold for wine applicable to only a few wine products in special circumstances. Nevertheless, it is observable that several Member States which tax wine do apply such a provision.
- **The reduced rate for "other fermented beverages", in light of the classification issues, may inadvertently give further support to products which, in the opinion of some, abuse the already lower rates of this excise category.** In connection with the abuse of the "other fermented beverages" category, the current threshold (8.5%) for a reduced rate for this category risks to create further incentives to develop products which are suspected to be only made to benefit from provisions of lower taxation. Additional research on this topic would be necessary (especially within the context in which the classification recommendations are taken

[45] To this effect, the findings reported in Section 8.4, dealing specifically with health aspects should also be considered.

up) to determine the extent to which the provision is appropriate in the light of the restated policy objectives.

- **The reduced rate for low strength ethyl alcohol is no longer of relevance.** Despite general support from the Member States regarding the appropriateness of the provisions for low-strength ethyl alcohol, only one Member State applies such a rate, and does so only for products containing less than 2.8% alcohol.

### 3.1.3 Reduced rates and exemptions for private production for own consumption

**Member States generally make use of the existing scope for applying exemptions on beer, wine and fermented beverages for own production.** No major negative consequences from the existence of these provisions have been reported.

**Opinions are more divided regarding the possibility of extending exemptions to cover intermediate products and ethyl alcohol**. Most Member States have a strong view on whether or not such exemptions should be allowed. Countries that favour extending the exemptions do so either because of the important role of traditional home-made spirits and production methods in their national culture, or because they believe that such exemptions would legalise alcohol production which would otherwise take place illegally. Countries that oppose the expansion of exemptions cite as their main reasons the perceived increased risk of (cross-border) fraud, higher administrative costs and burdens, and perceived health risks.

**Member States have contradicting views concerning the risk of fraud when exempting own production of alcohol.** Some countries believe that extending the scope of exemptions would reduce fraud, while others believe that doing so would increase it. There is also an inconsistency in the perceptions of how much revenue would be generated from taxing home-made intermediate products and ethyl alcohol, with some countries seeing the prospective yield as being too small to be worth the taxation burden, and others viewing the exemption of such products as a loss in tax revenue. In addition, little evidence has been provided in terms of health risks.

## 3.2 Reduced rates for small producers

In this section, we assess the relevance of the (presence and absence) of reduced rates for small producers for the different product categories. We present a summary of the findings on the impact on competition of reduced rates. The full analysis can be found in Appendix 7 – *In-depth case study on reduced rates for small producers*. Finally, the added value of setting rules for reduced rates at EU level is assessed.

With regard to small producers, the Directive allows for reduced rates. These, however only apply to the product categories "**beer**" and "**ethyl alcohol**".

For beer, Article 4 gives Member States the option to apply reduced rates to brewers producing no more than 200,000 hectolitres per year. For ethyl alcohol, Article 22 gives Member States the option to apply reduced rates to distillers producing no more than 10 hectolitres of alcohol per year or 20 hectolitres per year if such a reduced rate was already common in the Member State when the Directive was adopted. The amount of the reduced rates is specified not to be set more than 50% below the standard national rate of excise duty.

### 3.2.1 Continued relevance

The reduced rates are intended to reduce the economic burden for small producers allowing for fair competition on the internal market. Additionally, through these common rules the application of reduced rates is harmonised.

In particular, small producers may be disproportionately affected by market entry barriers, such as capital requirements and access to channels of distribution[46]. Where reduced rates for small producers are implemented, this would reduce their cost base, with a view to "levelling the playing field" by mitigating some of the disadvantages that may be faced by smaller producers (relative to larger producers) through reduced tax burdens.

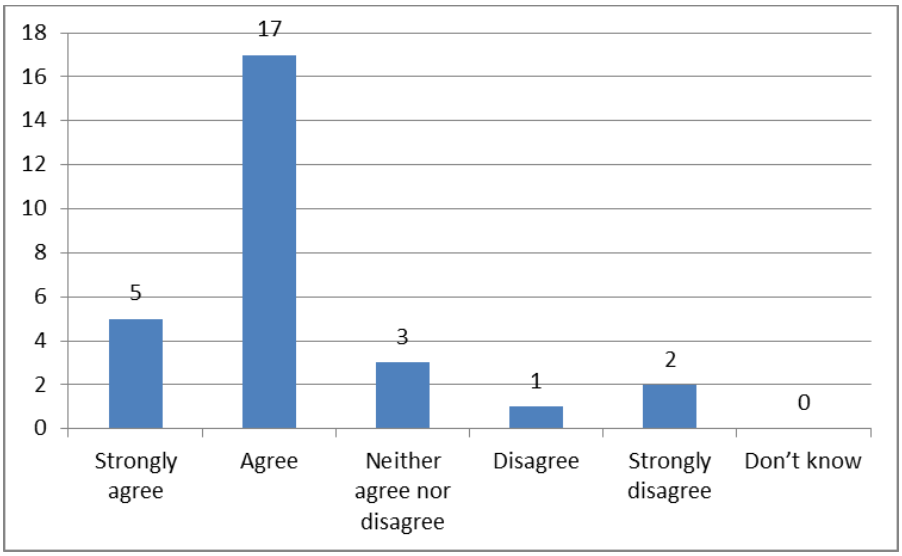
A **wide use of the reduced rates for small breweries** among the Member States, points to a continued relevance of the provision. **Reduced rates for small distilleries are less widely used** and considering stakeholder criticism that the rate is set at a too low level, the relevance of the rate is more questionable.

There is **no explanation why similar reduced rates for producers of other categories do not exist**. Stakeholder responses underline the limited relevance of this omission.

Overall, the Member States **expressed satisfaction** with the provisions regarding reduced rates for small producers. As Figure 11 shows, a total of 22 Member States indicated that the reduced rates for small producers met their needs. Only three Member States reported that this was not the case.

Two grounds for disagreement were cited by Member States: two of the authorities (IE, UK) were dissatisfied because there was **no relief for small cider producers** similar to the reduced rates available to small beer producers. For the other dissenting Member State (HU), the reduced rates under Article 22 (1) were **too limited in the level at which they can be set** and thus did not represent a tax relief.

**Figure 11:** ***Overall, the needs of my administration in terms of providing reduced excise duty rates for small producers are being met by the provisions of the Directive***

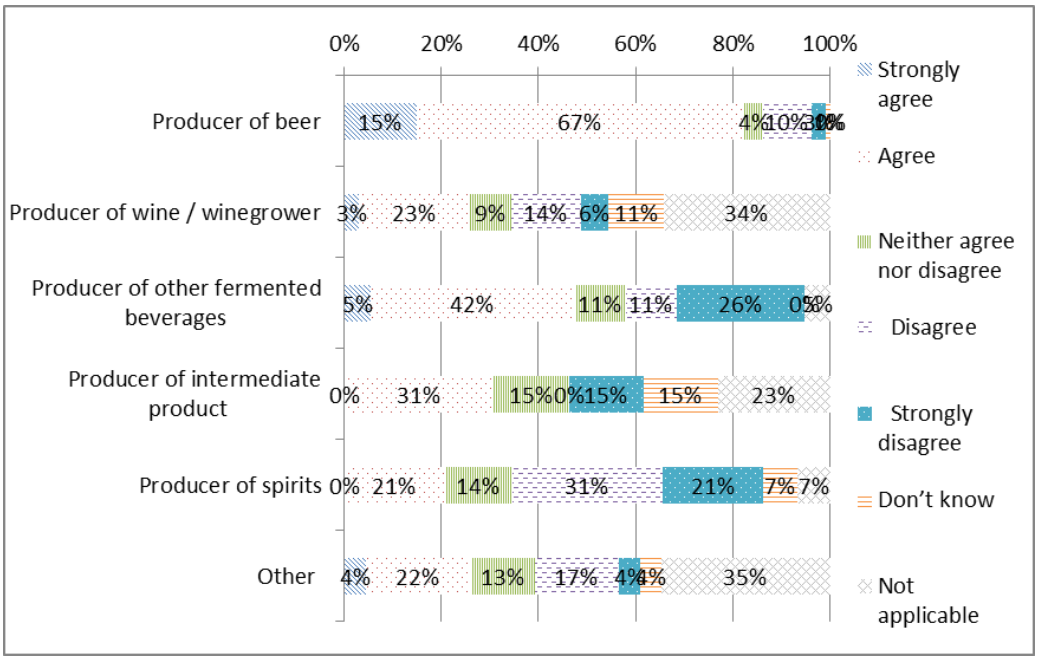



*Source: Survey to Member States*

The picture is less clear when analysing the responses of economic operators: As Figure 12 shows, only half of the respondents to the question (strongly) agreed that the provisions of the Directive regarding the reduced rates for small producers corresponded to their needs. A significant number of respondents (24% of the economic operators and trade associations) stated that the **needs of their industry were not being met** by the provisions regarding reduced rates for small producers.

[46] Further details are provided in Appendix 7 – *In-depth case study on reduced rates for small producers*

**Figure 12: *Overall, I find that the provisions of the Directive regarding the reduced rates for small producers correspond to the needs of the industry in which I operate*[47]*. (N=231)***




*Source: Survey to economic operators, August-November 2015*

When the results for each activity sector are analysed, they show that beer producers in particular assess the provisions on reduced rates for small producers more positively. However, as expected[48], more than half of the producers of spirits and 36% of the producers of other fermented beverages indicated that the reduced rates for small producers did not correspond to their needs.

Like the economic operators, the trade associations representing the beer producers expressed satisfaction with the reduced rates for small producers. Negative assessments of the reduced rates for small producers were expressed by those associations representing spirits producers and the producers of other fermented beverages.

Not surprisingly, a comparison of answers by indicated annual turnover shows that in particular, **producers with low turnover strongly agree that the reduced rates matched their needs**. Disagreement with the reduced rates was especially strong among producers with a turnover between EUR 50 m and 100 m, but was generally also stronger among producers with a turnover of EUR 10 m and higher.

In order to elucidate the stakeholders' assessments of the provisions at a granular and specific level, the following sections analyse each applicable provision in depth.

### 3.2.2 The specific conditions applicable to small brewers

As Table 9 shows, the current system gives the Member States a **high degree of flexibility** – a flexibility which has been taken up in the implementation of the provisions.

Seven Member States apply no reduced rates for small beer producers at all. Among those that do, 12 Member States have decided to implement the provisions for reduced rates for small producers up to the full extent of the maximum permitted threshold, while others have adopted smaller upper limits. The use of intermediate thresholds below which different tax rates can be applied is also popular among those Member States which apply reduced rates.

[47] Excluding trade associations; N=178. Note: the data labels indicate the relative share of respondents.
[48] The Directive does not allow the Member States to apply reduced rates for small producers of other fermented beverages. It allows Member States to apply reduced rates to producers of ethyl alcohol up to a threshold of 10 hl of pure alcohol.

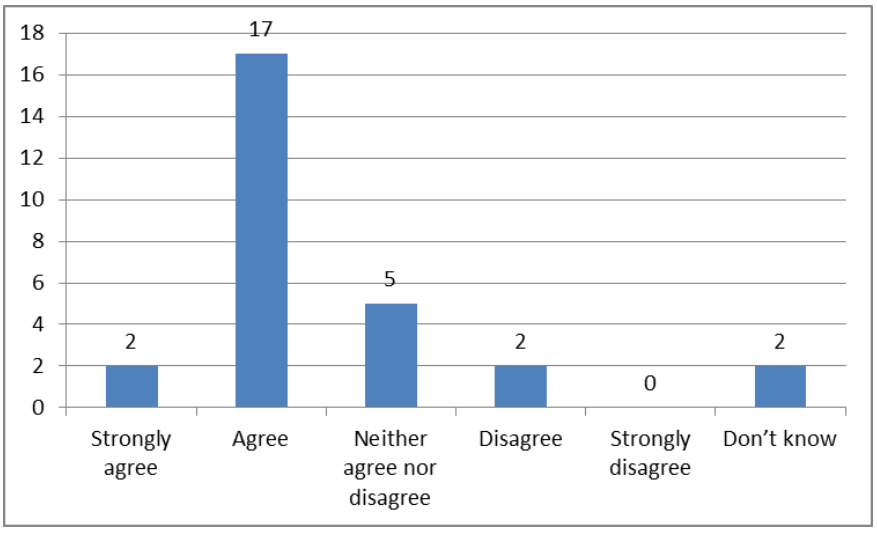
**Table 9: Overview of implementation of reduced rate for small brewers**

| Member State | Reduced rate for small brewers | Details |
|---|---|---|
| **AT** | √ | Limit of 50,000 hl; 3 intermediate thresholds with various rates |
| **BE** | √ | Limit of 200,000 hl; 4 intermediate thresholds with various rates |
| **BG** | √ | Limit of 200,000 hl |
| **CZ** | √ | Limit of 200,000 hl; 4 intermediate thresholds with various rates |
| **CY** | X | |
| **DE** | √ | Limit of 40,000 hl; 3 intermediate thresholds with various rates |
| **DK** | √ | Limit of 200,000 hl; 2 intermediate thresholds with various rates |
| **EE** | √ | Limit of 3,000 hl |
| **EL** | √ | Limit of 200,000 hl |
| **ES** | X | |
| **FI** | √ | Limit of 150,000 hl; 4 intermediate thresholds with various rates |
| **FR** | √ | Limit of 200,000 hl; 2 intermediate thresholds with same rate |
| **HR** | √ | Limit of 125,000 hl; 3 intermediate thresholds with various rates |
| **HU** | √ | Limit of 8,000 hl |
| **IE** | √ | Limit of 20,000 hl |
| **IT** | X | |
| **LT** | X | |
| **LU** | √ | Limit of 200,000 hl; 1 intermediate threshold with different rate |
| **LV** | √ | Limit of 10,000 hl |
| **MT** | X | |
| **NL** | √ | Limit of 200,000 hl; intermediate thresholds applicable in accordance with degrees Plato |
| **PL** | √ | Limit of 200,000 hl; intermediate thresholds applicable for lowering total tax output by various amounts |
| **PT** | √ | Limit of 200,000 hl; intermediate thresholds applicable in accordance with degrees Plato |
| **RO** | √ | Limit of 200,000 hl |
| **SE** | X | |
| **SI** | X | |
| **SK** | √ | Limit of 200,000 hl |
| **UK** | √ | Limit of 60,000 hl |

As Figure 13 shows, out of 28 Member States, 19 considered the limit for applying reduced rates to brewers producing no more than 200,000 hl per year to be appropriate. The authorities noted that the reduced rates **increased the competitiveness of small brewers**. They also underlined that it was important that this **limit should remain optional**. One Member State pointed out that these reduced rates had a long tradition in the sector.

Only two Member States (FI, IT) expressed discontent with the limit set, stating that in some Member States it was too high and no longer benefited only microbreweries.

**Figure 13:** ***The reduced-rate limit applied to brewers producing no more than 200,000 hectolitres per year is appropriate***




*Source: Survey to Member States*

63% of beer producers considered the limits for reduced rates to be appropriate. There were still 27% of beer producers (strongly) disagreeing that the reduced rates were appropriate. More than 75% of the trade associations representing beer producers (strongly) agreed that the reduced rates for brewers were appropriate for their industry. However, a number of associations (19%) strongly disagreed that the reduced-rate limits were appropriate.

An analysis based on the annual turnover of beer producers did not show a clear tendency for producers with a lower turnover to find the reduced rates for small brewers more appropriate than did producers with a higher turnover.

A detailed analysis of all the open-ended answers to the survey (i.e. all sectors of activity) reveals **a complex and uneven landscape of motivations for the answers given**. Notably:

- Some stakeholders (mainly associations of beer producers) would support either an increase of the threshold or a mandatory system whereby Member States would be forced to apply the maximum threshold (because some Member States are opting for a smaller upper limit, or appl different scales)
- A large group of respondents stated that they were satisfied with the current provisions (in particular, this applied to beer producers)
- A number of stakeholders have mentioned that an approximation between the allowance for beer and other alcoholic beverages (including distilleries as well as other categories currently not covered by the reduced rates) should be ensured. (This view was expressed primarily by producers of spirits and other fermented beverages.)

The latter group expressed diverse views, desiring to see a reduction in the threshold for beer, an increase in the threshold for other categories, or a combination of both.

### 3.2.3 The specific conditions applicable to small distilleries

Only five Member States (DE, ES, AT, PT[49] and RO) apply reduced rates for small distillers. Those Member States that apply a reduced rate for fruit spirits produced by fruit growers are treated separately in Section 3.5.1.

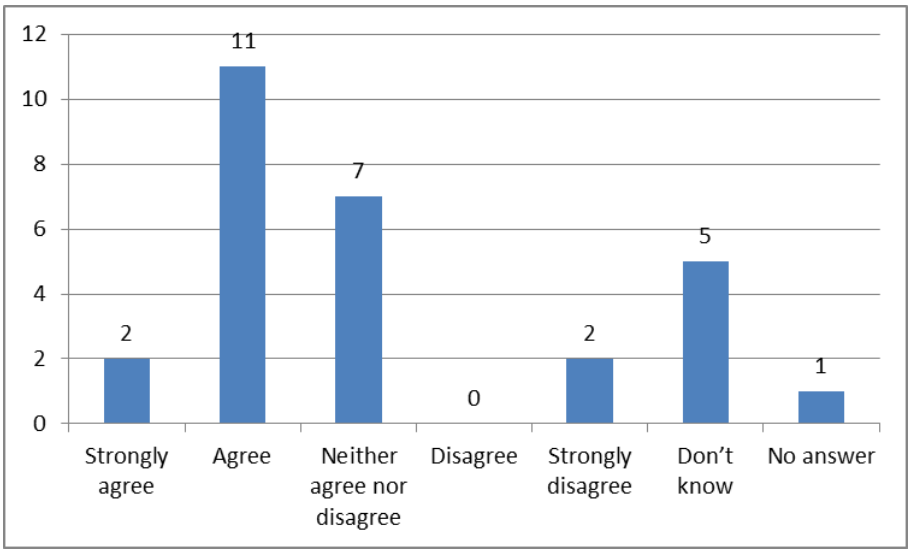
[49] In PT, a threshold of 4 hl is applicable.

The results of the survey show that, among Member States, satisfaction with a limit applying reduced rates to distillers producing no more than 10 hl of alcohol per year, or 20 hectolitres per year if such a limit was nationally applied before the Directive was adopted, was weaker than for the reduced rates for small breweries.

Nevertheless, 13 out of 28 Member States indicated that they considered the limit to be appropriate. These Member States noted that the reduced rates were set at a level that **allowed for support of small producers while still not incentivising the consumption of products with high alcohol content** over products having a lower alcoholic strength. One Member State also noted that these reduced rates had a long tradition.

Two Member States strongly disagreed with the limits set. One of them (HU) noted that the **limit for the production quantity was set too low** and would not permit any producer to run a profitable business. The other Member State (SK) expressed concern about the differences among the Member States in their approach to, and conditions for, the production of distilled alcohol in small distilleries.

**Figure 14:** ***The reduced rates limit for distillers producing no more than 10 hectolitres of alcohol per year, or 20 hectolitres per year if such a reduced rate was provided nationally when the Directive was adopted is appropriate***




*Source: Survey to Member States*

Generally speaking, the producers of alcoholic beverages and their trade associations did not express strong opinions regarding the reduced rates for smaller distillers. 34% neither agreed nor disagreed that the rates were appropriate. However, **spirits producers displayed dissatisfaction** with the reduced rates applicable to small distilleries. Almost half of them (strongly) disagreed that the reduced rates were appropriate. Only 12% thought that they were appropriate. The trade associations representing the spirits industry were less clear-cut in their responses. 26% (strongly) agreed that the reduced rates were appropriate, while a larger proportion – 42% – (strongly) disagreed.

An analysis based on the annual turnover of spirits producers did not show a clear tendency for producers with a lower turnover to find the reduced rates for small distilleries more appropriate than did those with a higher turnover.

From the analysis of the open-ended answers provided by all economic operators and their trade associations, it can be seen that a majority of those expressing dissatisfaction with the provisions considered that the **threshold of 10 hl is too low**; one association

in particular explained that such a limit is equivalent to just 3,571 bottles (or, in terms of their stated perspective, 10 bottles per day).

### 3.2.4 The (lack of) rules allowing reduced rates for small producers in other categories

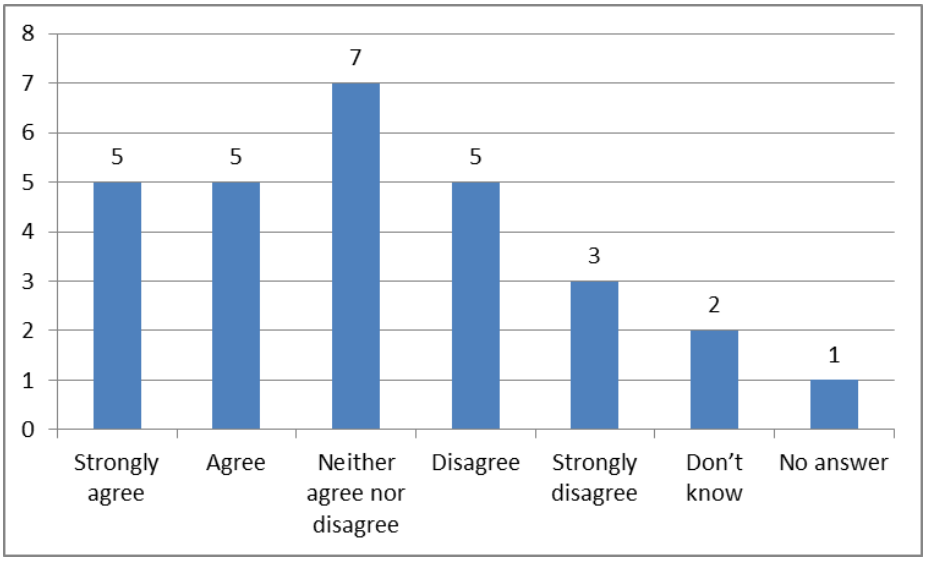
The suggestion of introducing reduced rates for small producers of still and sparkling wines, other fermented beverages and intermediate products led to **opposing views** being expressed by the stakeholders consulted.

As Figure 15 shows, out of 28 Member States, ten (AT, BG, EL, HU, IE, MT, PL, PT, SK, UK) indicated that they (strongly) supported such a suggestion, while eight (CZ, EE, ES, FI, FR, HR, LT, NL) were (strongly) opposed to it.

Those in favour of introducing reduced rates for other small producers stated that their **unequal treatment** compared to other products should be eliminated, and that there was strong support at the national level for implementing such a provision if it existed. The reduced rates would allow the Member States to treat all small alcohol producers fairly according to their own national circumstances. This provision would be particularly relevant for Member States that apply a positive excise rate to wine. Authorities expressing their support for this idea (some of which also apply a zero rate to wine) indicated that they understood and supported the needs of these Member States.

The Member States that expressed disagreement with the suggestion of introducing reduced rates for other small producers primarily argued that **additional reduced rates would add yet more complexity** to the excise duty landscape, and that there were already sufficient derogations, such as reduced rates based on low alcoholic strength. In their view, further exceptions would have distorting effects on the internal market, would be costly to implement, and might even lead to tax evasion. Two Member States simply noted that they were applying a zero tax rate on wine and therefore did not need a reduced rate for small producers.

**Figure 15:** ***The possibility of applying reduced rates should also be introduced for still and sparkling wines, other fermented beverages and intermediate products***



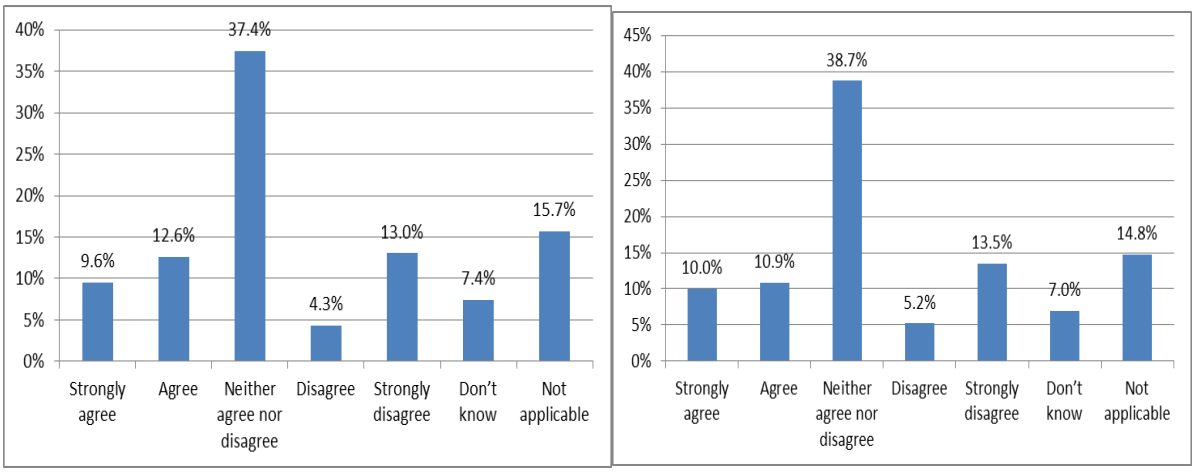

*Source: Survey to Member States*

When looking at the views of the industry, as depicted in Figure 16, it is clear that most producers and trade associations **found it difficult to assess** whether the absence of the possibility of introducing reduced rates for small producers of other products than beer and spirits would create competitive disruptions (this was indicated by the large number of respondents who neither agreed nor disagreed with the statement).

An almost equal share of respondents either (strongly) agreed (23%) or (strongly) disagreed (17%) that competitive disruptions are being caused by the absence of the possibility of permitting reduced rates for additional categories of alcoholic beverage.

A similar picture emerges in relation to the question regarding the possibility of unfair tax advantages: 39% of the producers and trade associations of alcoholic beverages indicated that they neither agreed nor disagreed with the statement that the absence of the possibility to introduce reduced rates for small producers of other products than beer and spirits created unfair tax competition. 21% of respondents (strongly) agreed, while 19% (strongly) disagreed that unfair tax competition would be created.

**Figure 16:** ***The absence of the possibility to establish reduced rates for small producers of still and sparkling wines, other fermented beverages and intermediate products creates competitive disruptions / unfair tax advantages.*** **(N=230)**



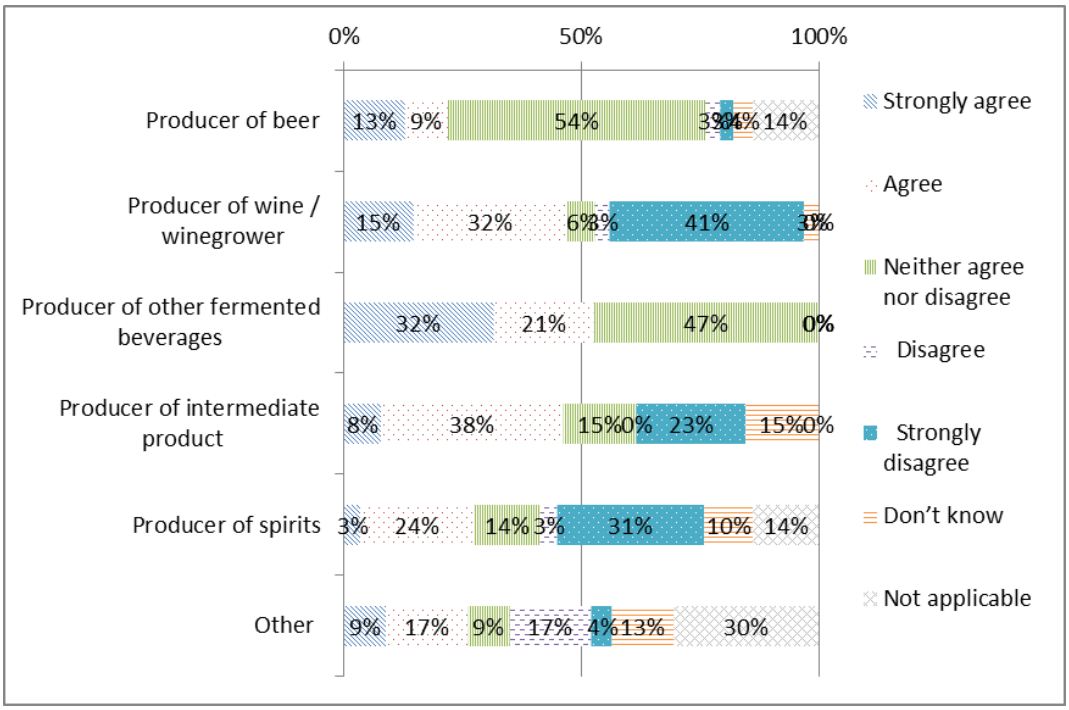

*Source: Survey to economic operators, August-November 2015.*

It is clear from analysing the open-ended answers to these questions that the stakeholders generally found it difficult to answer this question qualitatively, and that some who did so provided incomplete or partly irrelevant reasons for their answers. Accordingly, this evaluation has turned to a quantitative analysis of economic data (see Appendix 7 – *In-depth case study on reduced rates for small producers* and Section 3.2.5) to provide a more adequate source for answering these questions.

As can be seen from Figure 17, the responses regarding the possible need to introduce reduced rates for small producers of wine, other fermented beverages and intermediate products were split in a similar way to those given in response to the two previous questions on competitive disruptions and unfair tax competition. Most operators and trade associations neither agreed nor disagreed with the proposition. 25% of the respondents would like to see the introduction of such reduced rates, while 19% spoke out against them.

Among the different types of economic operator, responses to the question about the potential introduction of reduced rates for small producers of products other than beer and spirits were split according to the sector of activity. Only producers of other fermented beverages gave more than 50% positive responses, demonstrating their (strong) **agreement that such a reduction should be introduced**.

**Figure 17: *Reduced rates should also be introduced for small producers of still and sparkling wines, other fermented beverages and intermediate products*[50]**




*Source: Survey to economic operators, August-November 2015*

Among the trade associations too, the responses to the question about an introduction of reduced rates for small producers of products other than beer and spirits were polarised.

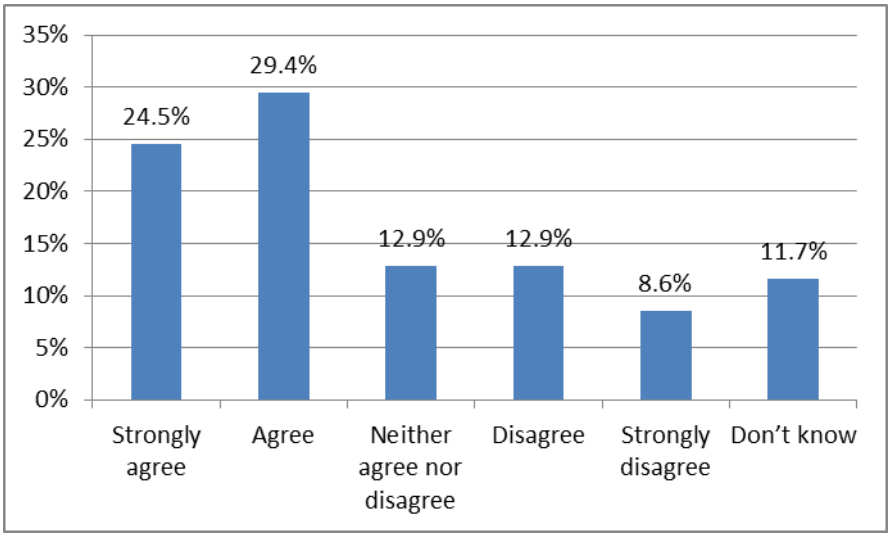
Like the economic operators, 75% of the associations representing producers of other fermented beverages strongly agreed that they would like to see such reduced rates introduced, while wine and spirit associations generally disagreed.

More than half of the respondents to the open public consultation from all types of respondents (strongly) agreed that the rules for small producers should apply to all categories of alcohol and alcoholic beverages. They argued that all **small producers, regardless of the product they produced, should receive support**, and that it was important to avoid distorting competition among the various products.

Opposition to the perceived need to establish reduced rates for all small producers was indicated by 22% of the respondents to the open public consultation which were mainly NGOs and consumers. They again referred to the **need to protect consumer health**, and stated that there should therefore be no reduced rates at all. Others argued that the categories of alcohol and alcoholic beverage were so different that there was no need to apply the same rules to all of them.

[50] Excluding trade associations; N=177

***Figure 18: The rules for small producers should apply to all categories of alcohol and alcoholic beverages (N=163)***




*Source: Public consultation, August-November 2015*

### 3.2.5 Do reduced rates introduce competitive distortions? – Quantitative analysis

In the surveys to Member States and economic operators, several stakeholders suggested that potential competitive distortions are being created by the existence of reduced rates for small producers, and also by the inconsistent application of these reductions across both products and Member States.

In order to investigate whether these claims are likely to be material, and whether the implementation of reduced rates for small brewers and small distillers does actually introduce competitive distortions, we carried out an analysis of the competitive situation in the UK, France, Germany, Spain and Italy. The complete study can be found in Appendix 7 – *In-depth case study on reduced rates for small producers*. The selection of these Member States was driven by data availability; nonetheless, these five countries represent interesting examples for consideration:

- The UK is interesting, as beer and spirits account for the majority of alcohol produced in the UK, but reduced rates are only available for small brewers.
- The majority of alcohol produced in France is wine (which is taxed), but rate relief (in relation to production) is provided to small brewers only.
- Germany is an interesting case, as it has reduced rates for small producers of both beer and ethyl alcohol, while its alcohol production is mainly focused on beer.
- Spain is interesting too, because it has reduced rates for spirits producers but not beer producers.
- Italy does not have reduced rates for small producers, but wine is its main product in terms of production, which is exempt from excise duty. This therefore provides an interesting study of the extent to which small beer and spirits producers are affected by taxation relative to larger producers, and also the extent of competition being faced from untaxed wine.

Across the board, a similar picture emerged: the volume of beer and ethyl alcohol being produced in these Member States that is likely to benefit from reduced rates is sufficiently small as to be **unlikely to create any distortions in competition** — within markets (e.g. beer produced by small brewers vs. beer produced by large brewers), across markets receiving reduced rates (e.g. beer produced by small brewers vs. spirits produced by small producers subject to tougher qualifying thresholds), or across all markets (e.g. beer produced by small producers vs. other fermented beverages not subject to any reduction in rates).

In order to probe this finding further, we looked at a range of competition indicators in each Member State, such as concentration ratios, trade statistics and profitability, and the same pattern continued to emerge. Therefore, while the Directive as it stands may

not meet all tax authorities' and economic operators' needs, it does not appear to be impacting the market in a detrimental way by distorting competition (beyond the extent to which the reduced rates on offer are able to level the playing field between smaller producers and larger producers).

Interpretation of the results is difficult given the limitations to the analysis described above. One interpretation of the results of our analysis would be that the reduced rates help to level the playing field, but that the gains available to larger producers from economies of scale are large enough to outweigh any gains to small producers that accrue from the reduced rates. For the purposes of this evaluation, it can be concluded that **reduced rates for small producers are not having a detrimental impact on competition**.

However, while this may be the case at the level of the overall market, there could well be distributional effects that encourage certain producers to feel that the presence or absence of reduced rates is creating unfair competitive pressure in their market. With this in mind, we refer to the responses to the survey from both national tax administrations and economic operators with regard to the appropriateness of the common rules for small producers which have been presented above.

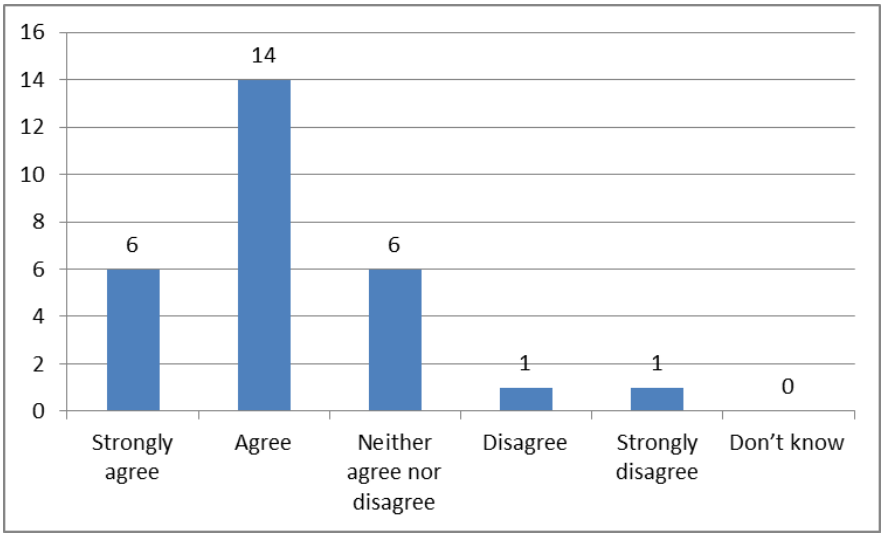
### 3.2.6 EU added value

As they are widely being used, setting reduced rates for small breweries at EU level provides the added value of a consistent approach. The limit for reduced rates in the Directive ensures that reduced rates cannot be set at a level where they would present a distortion to competition.
Although, more rarely used, the same applies to reduced rates for small distilleries. **Consistent limits across the EU** ensure that competition within and between the Member States is not distorted.

Stakeholders overall considered the reduced rates for small producers to create EU added value.

As Figure 19 shows, overall, Member States agreed that the possibility of setting reduced rates for small producers of alcohol and alcoholic beverages should be decided at the EU level, as should the applicable limits.

**Figure 19:** ***The possibility of setting reduced rates for small producers of alcohol and alcoholic beverages and the applicable limits should both be decided at the EU level (as it is currently)***




*Source: Survey to Member States*

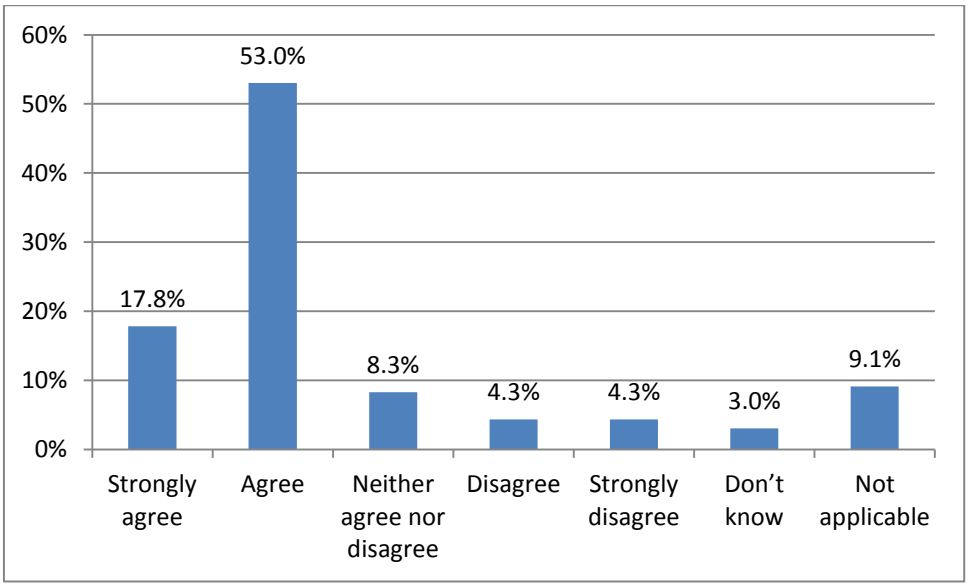
The 20 Member States (strongly) agreeing noted that setting the basic rules at the EU level would support the application of a **uniform approach**. It would **support the**

**approximation of national excise duty rates** and avoid distortion of competition between Member States by ensuring that similar protection for the same types of producers is applied. Member States also underlined that the exact level of the reduced rate applied should be decided at the national level.

The two Member States which disagreed with the proposition that reduced rates for small producers should be set at the EU level did not suggest that the provisions did not have any added value or should be discontinued, but expressed disagreement regarding the content of the provisions: concretely, one of the dissenting Member States (EL) noted that the term **"small producer" should be defined in different terms**, while the second (SK) argued for even more competitive conditions for small producers.

As far as the producers are concerned, the respondents saw clear added value from setting reduced rates at the EU level. More than 70% indicated that common rules for reduced rates for small producers of alcohol and alcoholic beverages for excise purposes should be set at the EU level, as they are currently. There were no significant differences in the views expressed by operators across the different product categories.

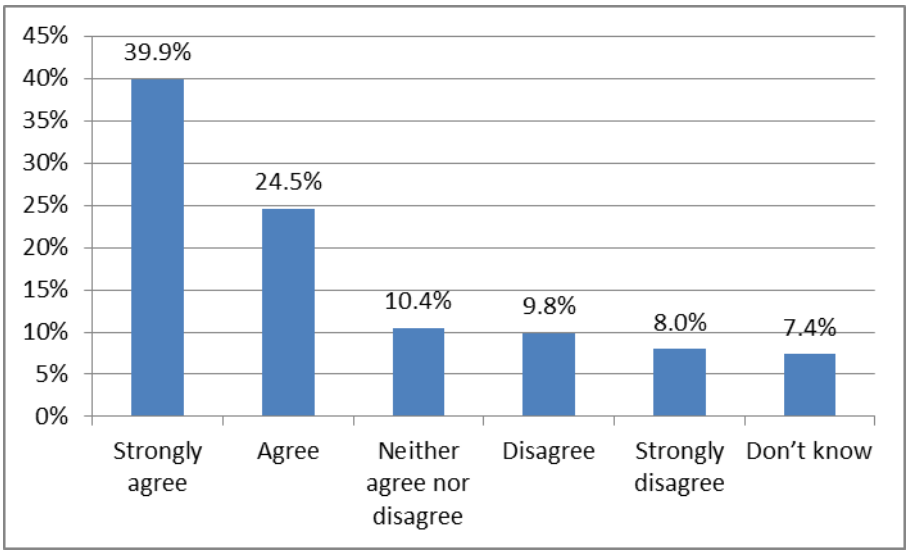
**Figure 20: *Overall, I believe that common rules for reduced rates to small producers of alcohol and alcoholic beverages for excise purposes should be set at the EU level (as they are currently*). (N=230)**




*Source: Survey to economic operators, August-November 2015*

Among the respondents to the open public consultation**,** there was strong agreement that there are overall benefits from establishing common rules for the application of reduced rates to small producers across the EU. In total, 65% (strongly) agreed that common rules for reduced rates for small producers were beneficial. They argued that having common rules for all the Member States was important for a functioning internal market. Many also noted that it was necessary to specifically support small producers in order to **permit a level playing field**. Only 18% of respondents disagreed with this statement. These were primarily citizens and NGOs; they argued that the **impact of alcohol on health** should be the primary consideration, so alcohol and alcoholic beverages should consistently be subject to high excise duties.

**Figure 21:** ***There are overall benefits from establishing common EU rules for the application of reduced rates to small producers across the EU*** **(N=163)**




*Source: Public consultation, August-November 2015*

## 3.3 Alcoholic beverages below a particular alcoholic strength

The Directive allows the Member States to apply reduced rates to all categories of alcoholic beverage when they lie below a certain level of alcoholic strength. Member States may apply reduced rates to:

- beer with an actual alcoholic strength not exceeding 2.8% vol; (Article 5.)
- still and sparkling wine of an actual alcoholic strength by volume that does not exceed 8.5%; (Article 9.3)
- still and sparkling other fermented beverages of an actual alcoholic strength not exceeding 8.5% vol; (Article 13.3)
- intermediate products with an actual alcoholic strength by volume not exceeding 15% vol if that reduced rate is neither set at more than 40% below the standard national excise rate, nor lies below the standard national rate for wine and other fermented beverages; (Article 18.3)
- ethyl alcohol with an actual alcoholic strength by volume not exceeding 10%; (Article 22.5).

The following sections analyse the views of stakeholders[51] in order to elucidate whether the existence of these reduced rates and the limits set in the Directive for their application are still considered to be relevant.

### 3.3.1 Overall relevance of reduced rates for products below a particular strength

As the Directive does not refer to health policy as one of its objectives, the relevance of reduced rates for products below a particular alcoholic strength can only be judged against its aim to ensure a consistent application of reductions across the EU. From this perspective common rules for low strength products continue to be needed to ensure a level playing field between operators from different Member States.

A simple analysis of the opinions of stakeholders in relation to the provisions governing reduced rates for alcohol below a certain alcoholic strength shows that, overall, the **majority of stakeholders consider the status quo to be appropriate,** and that they

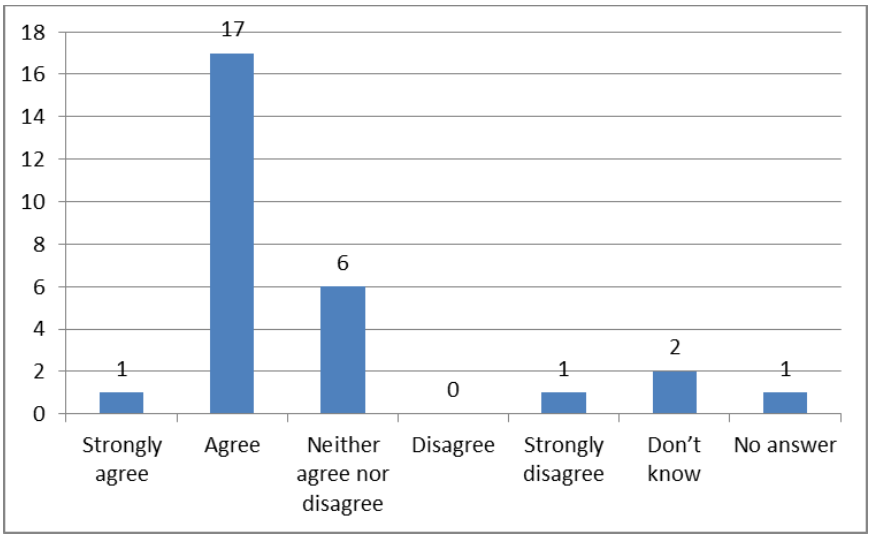
[51] It should be noted that the assessments of the stakeholders when giving their opinions on the appropriateness of the provisions were not only subjective in relation to their own positions (e.g. economic operators in different sectors or even different operators within the same sector), but were also benchmarked against different objectives (e.g. some stakeholders were considering the appropriateness of the provisions in light of current or future tax advantages, while others were taking into account the competitive positions of some products over others). Consequently, this section limits itself to presenting the positions of the different stakeholders while pointing out specific considerations relating to each product category.

evaluate its functioning positively, given the overall needs of the Member States and their industry. However, while this may be true at the overall level, a deeper analysis of all the various opinions expressed, as well a consideration of the interests of each stakeholder group, leads to a more complex picture of the reality.

As can be observed in Figure 22, the Member States were generally satisfied with the possibility of applying reduced excise duty rates for alcoholic beverages below a certain alcoholic strength. In total, 18 Member States (strongly) agreed that their needs were being met by the available provisions. Two Member States (BE, SE) additionally noted that they supported the existence of such reduced rates, as they **allowed the promotion of alternatives** containing less alcohol, which in their opinion were better for consumers' health, and were working towards a system of taxing products based solely on their alcoholic content.

The Member State that indicated strong dissatisfaction with the available provisions (MT) noted that it did not provide reduced rates for beverages of a low alcoholic strength at the national level. Six Member States neither agreed nor disagreed, one of them noting that no reduced rates were applied in their country.

**Figure 22:** ***Overall, the needs of my Member State in terms of providing reduced excise duty rates for alcoholic beverages below a certain alcoholic strength are being met by the provisions of the Directive***

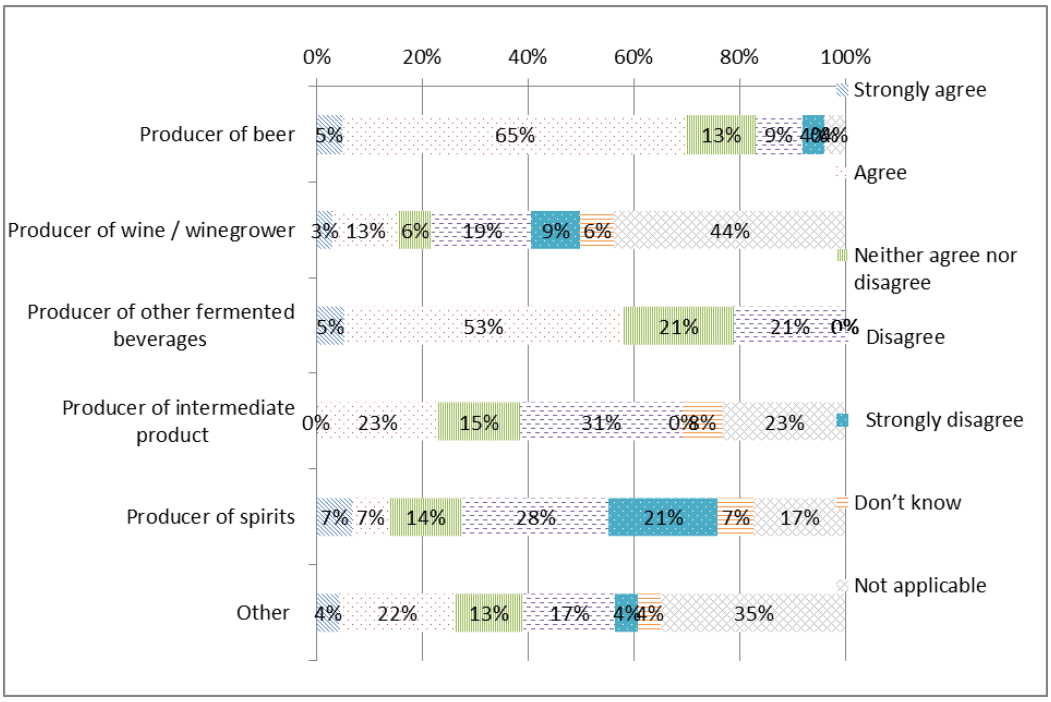



*Source: Survey to Member States*

Overall, producers of alcoholic beverages and their trade associations agreed that the provisions of the Directive regarding the reduced rates for alcoholic beverages below a certain alcoholic strength corresponded to their needs. However, more than 20% of respondents (strongly) disagreed.

If we consider the views of each industry (Figure 23), we can see that while a majority of the producers of beer and other fermented beverages indicated satisfaction with the reduced rates for beverages below a certain alcoholic strength, almost half of the spirits producers (strongly) disagreed that their needs were being met by the available reduced rates. When the wine producers from Member States with a zero rate for wine are disregarded 50% of the wine producers also (strongly) disagreed that their needs were being met. The responses of the producers of intermediate products indicated no strong trend towards satisfaction or dissatisfaction with the reduced rates.

**Figure 23: *Overall, I find that the provisions of the Directive regarding the reduced rates for alcoholic beverages below a certain alcoholic strength correspond to the needs of the industry in which I operate*[52]**




*Source: Survey to economic operators, August-November 2015*

Taking into account the views of industry representatives, over 60% of the associations representing beer producers agreed that the needs of the industry were being met by the reduced rates for beverages of a lower alcoholic strength. But interestingly, while the producers of other fermented beverages appeared to be fairly satisfied with the reduced rates themselves, over 60% of their trade associations indicated that they (strongly) disagreed that their needs were being met. Among the trade associations for spirits producers, we can observe a trend towards dissatisfaction with the reduced rates, while the answers given by the wine producers' associations showed no clear tendency.

Because the views expressed by stakeholders across the alcohol industry regarding the appropriateness of the provisions are less than unequivocal, the following sections analyse each individual provision separately.

It is very important to note that the views expressed by each industry sector on this topic reflected their concerns (and interests) with regard to the competition that might arise from the tax advantages / disadvantages which the implementation of these provisions could have for their own sector, and did not consider either of the two respective objectives which the legislator regarded as being the raison d'être for their inclusion in the Directive and their implementation at the national level.

This finding is important, as it shows that any initiative in this area should not only look at the potential impact that reduced rates for lower-strength alcohol beverages might have on the production and consumption of these products individually (and any other policy goals they might want to pursue), but also at the competitive distortions these might have (or be perceived to have) within and between categories. Such an analysis would also have to take into account the complexity caused by the fact that the interaction between the reduced rates across the different categories might undermine the objectives of the initiative in the first place (e.g. due to the unintended increase in

[52] Excluding trade associations; N=174

consumption of a higher-strength alternative which would also benefit from a reduced rate being applied in another category).

### 3.3.2 Beer not exceeding 2.8%

Only six Member States (ES, DK, IE, PT[53], FI and UK) are implementing a reduced rate for beer not exceeding 2.8%. Among those that do so, some apply a zero rate, either for all beer below the upper threshold (DK), or for beer below 1.2% (ES[54], IE[55]).

The survey results show that while ten Member States indicated that they considered the limit below which Member States can apply reduced rates for beer to be appropriate (BG, DK, EE, ES, FR, IE, LT, LU, NL, SE), a further twelve Member States neither agreed nor disagreed with the limit. Only two Member States indicated not being in favour of the limit for the reduced rate (MT, UK).

Those Member States which were satisfied with the provisions concerning reduced rates for beer of low alcoholic strength noted that these rates could incentivise the **consumption of less harmful products**. Others indicated that they had not heard any complaints, and were therefore satisfied.

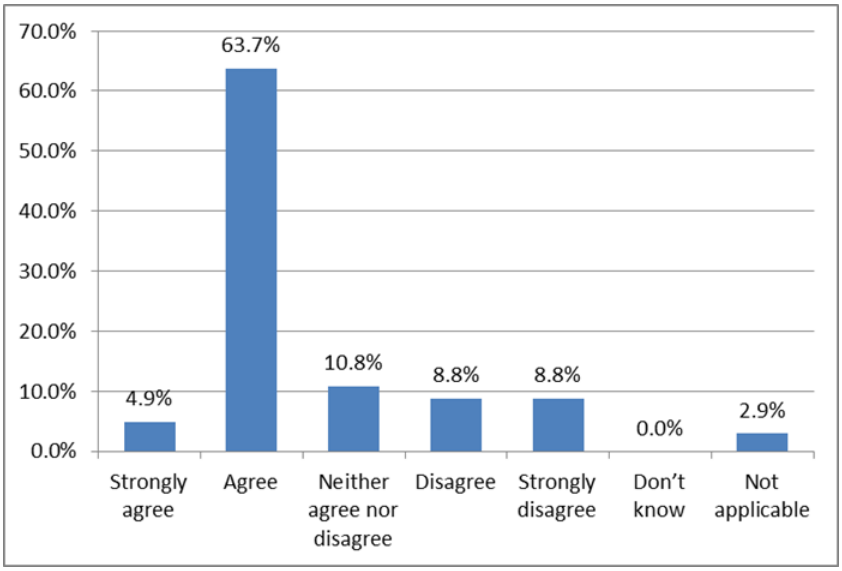
Those Member States that expressed no clear opinion (i.e. that neither agreed nor disagreed) mostly noted that they did not apply the reduced rate and were therefore not affected by the limit. One of the two Member States which expressed dissatisfaction with the provisions noted that many brewers would **welcome an increase in the current threshold from 2.8% to 3.5%,** arguing that this would increase the range of choice of lower-alcohol products, and would therefore provide a greater incentive for some people to drink lower-strength products (UK). The other Member State expressing dissatisfaction indicated that it did not apply the reduced rate (MT).

Overall, the economic operators and trade associations for the alcoholic beverage industry considered the limit below which Member States may apply reduced rates to beer to be appropriate. However, 19% of the respondents expressed dissatisfaction with the reduced-rate provisions.

When only the responses of beer producers are taken into account, a similar proportion of respondents (18%) indicated dissatisfaction with the provisions.

[53] PT only applies a reduced rate for beer below 1.2%.
[54] For beer below 2.8%, a reduced rate applies.
[55] Ibid., 54.

**Figure 24: *I find that the limit below which Member States may apply reduced rates for beer (beer with actual alcoholic strength not exceeding 2.8%) to be appropriate*[56].**




*Source: Survey to economic operators, August-November 2015*

Among the trade associations representing beer producers, there is strong satisfaction with the reduced rates for beer of lower alcoholic strength. However, 4 out of 21 associations (strongly) disagreed that the reduced rates were appropriate.

From our analysis of the open-ended answers given by economic operators in response to this question, it was apparent that those expressing dissatisfaction with the current provisions **would like to see the limit increased** (3.5% being mentioned by several respondents); however, the **vast majority of answers considered the current limit to be appropriate**.

While the current provisions are largely accepted as being appropriate (partly because the excise duty on beer is already proportional to its alcoholic strength)[57], one Member State and (unsurprisingly) some parts of the beer industry believe that a higher threshold would be more appropriate and would serve to support (i.e. give a preferential tax treatment to) a larger share of the beer market.

### 3.3.3 Still and sparkling wine not exceeding 8.5%

As can be seen in Table 10, among the Member States which apply a positive rate to wine, nine apply a reduced rate to wine below 8.5%, although not all make use of the full upper limit allowed by the Directive.

[56] Beer producers only; N=102
[57] N.B. This statement is more accurate for those cases where the Member States apply an excise rate based on alcohol content; though a correlation may also exist for those states which use degrees Plato, the relationship is not as straightforward.

**Table 10: Overview of the implementation of a reduced rate for wine below 8.5%**

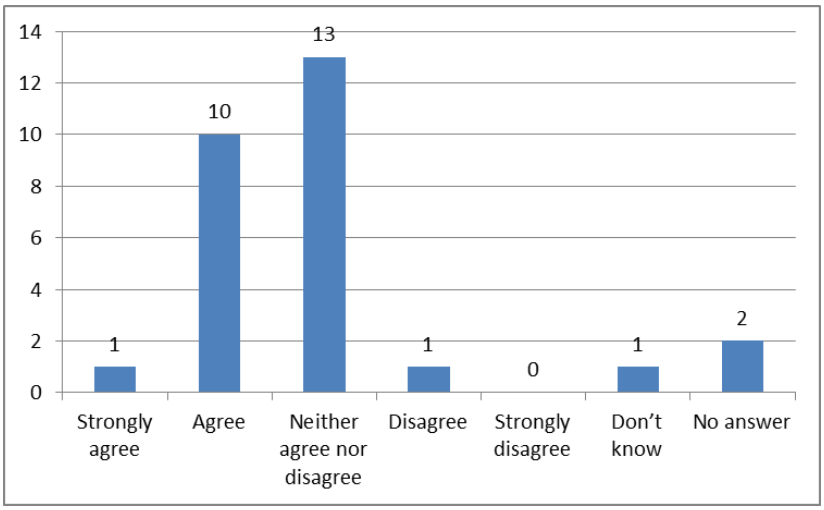
| Member State | Reduced rate for wine below 8.5%[58] | Details |
|---|---|---|
| **AT** | n/a | |
| **BE** | √ | Reduced rate for wine below 8.5% |
| **BG** | n/a | |
| **CY** | n/a | |
| **CZ** | n/a | |
| **DE** | n/a | Reduced rate for sparkling wine below 6% |
| **DK** | √ | Reduced rate for wine below 6% |
| **EE** | √ | Reduced rate for wine below 6% |
| **EL** | X | |
| **ES** | n/a | |
| **FI** | √ | Reduced rate for wine below 8%, 2 intermediate thresholds with varying rates |
| **FR** | X | |
| **HR** | n/a | |
| **HU** | n/a | |
| **IE** | √ | Reduced rate for wine below 5.5% |
| **IT** | n/a | |
| **LT** | √ | Reduced rate for wine below 8.5% |
| **LU** | n/a | |
| **LV** | X | |
| **MT** | X | |
| **NL** | √ | Reduced rate for wine below 8.5% |
| **PL** | X | |
| **PT** | n/a | |
| **RO** | n/a | |
| **SE** | √ | Reduced rate for wine below 8.5%, 3 intermediate thresholds with varying rates |
| **SI** | n/a | |
| **SK** | n/a | |
| **UK** | √ | Reduced rate for still wine below 5.5%, with intermediate thresholds with varying rates, reduced rate for sparkling wine of >5.5% <8.5% |

In our assessment, the widespread zero rates for wine, together with the rigid EU and international agricultural and commercial standards which are applicable in the wine industry, render the 8.5% threshold for wine **largely irrelevant to all but a few wine products in special circumstances**.

The reasoning of the Member States which considered that the alcohol limit below which reduced rates for wine can be applied was appropriate was very similar to that indicated for the reduced rates for beer of lower alcoholic strength. 11 Member States (BG, DE, DK, EE, ES, FI, HU, LT, NL, RO, SE) indicated that they found the limit to be appropriate, noting that the rates could **stimulate investment in new products** of lower alcoholic strength, and that there was no need to raise the available limit. The 13 Member States with no strong opinion on the matter (i.e. which neither agreed nor disagreed), as well as those Member States that indicated disagreement, mostly did not apply reduced rates to wine of low alcoholic strength.

[58] Member States for which still wine is zero-rated are marked as "n/a" in this column; however, please note that some of them may apply a positive rate to sparkling wine.

**Figure 25:** ***The limit below which the Member States may apply reduced rates for wine (still and sparkling wine of an actual alcoholic strength not exceeding 8.5% vol) is appropriate***




*Source: Survey to Member States*

Within the industry, the responses to the question of whether the reduced rates for wine of lower alcoholic strength were appropriate were less unequivocal – though overall, the number of respondents (strongly) agreeing and those (strongly) disagreeing was almost equal. If we look purely at the responses from the wine sector[59], we can observe that the majority of wine producers and their associations reported that they considered the provisions for reduced rates for wine of lower alcoholic strength to be appropriate. 35% of the respondents even indicated their strong agreement concerning the appropriateness of the reduced rates. However, more than a quarter of the wine producers and three out of the 15 organisations representing their views expressed dissatisfaction with the reduced rates.

An analysis of the open-ended answers given by respondents from all the activity sectors shows that many of those that gave neutral answers (neither agree nor disagree; don not know or not applicable), as well as expressing dissatisfaction with the provisions did so not because they believed the limit itself should be adjusted, but out of **general dissatisfaction with the entire system**, which in their view creates and magnifies the differences between alcoholic beverages that fall into different excise tax categories. The message of those respondents was that "*the scheme of reduced rates* [for alcohol below a particular strength] *should not favour any category of alcoholic beverages the way it currently does"*. This consideration is valid for all the other categories of products discussed in this section.

### 3.3.4 Still and sparkling "other fermented beverages" not exceeding 8.5%

As can be observed in Table 11, among those Member States which apply a positive rate to other fermented beverages, 12 apply a reduced rate for products below 8.5%, although not all make use of the full upper limit allowed by the Directive, and most of them differentiate between cider, perry and the other products that fall into this category.

[59] Producers of wine / wine growers only; N=34

**Table 11: Overview of implementation of reduced rate for wine below 8.5%**

| Member State | Reduced rate below 8.5%[60] | Details |
|---|---|---|
| **AT** | n/a | |
| **BE** | √ | Reduced rate below 8.5% |
| **BG** | n/a | |
| **CY** | n/a | |
| **CZ** | n/a | |
| **DE** | n/a | Reduced rate for sparkling "other fermented beverages" below 6% |
| **DK** | √ | Reduced rate below 6% |
| **EE** | √ | Reduced rate below 6% |
| **EL** | X | |
| **ES** | n/a | |
| **FI** | √ | Reduced rate below 8%, 2 intermediate thresholds with varying rates |
| **FR** | X | |
| **HR** | n/a | |
| **HU** | √ | Zero rate for unflavoured still mixtures of wine and carbonated water below 8.5% |
| **IE** | √ | Reduced rate for cider and perry below 8.5% with 2 intermediate thresholds. Different reduced rate for other types of fermented beverages below 5.5% |
| **IT** | n/a | |
| **LV** | √ | Reduced rate below 6% |
| **LT** | √ | Reduced rate below 8.5% |
| **LU** | n/a | |
| **MT** | X | |
| **NL** | √ | Reduced rate below 8.5% |
| **PL** | √ | Reduced rate for cider and perry below 5% |
| **PT** | n/a | |
| **RO** | X | |
| **SE** | √ | Reduced rate below 8.5%, 3 intermediate thresholds with varying rates |
| **SI** | n/a | |
| **SK** | n/a | |
| **UK** | √ | Reduced rate for still cider and perry below 8.5%, with an intermediate threshold with varying rates. Reduced rates for other fermented still beverages below 8.5% with 2 intermediate thresholds, and reduced rates for other sparkling fermented beverages below 5% with 1 intermediate threshold |

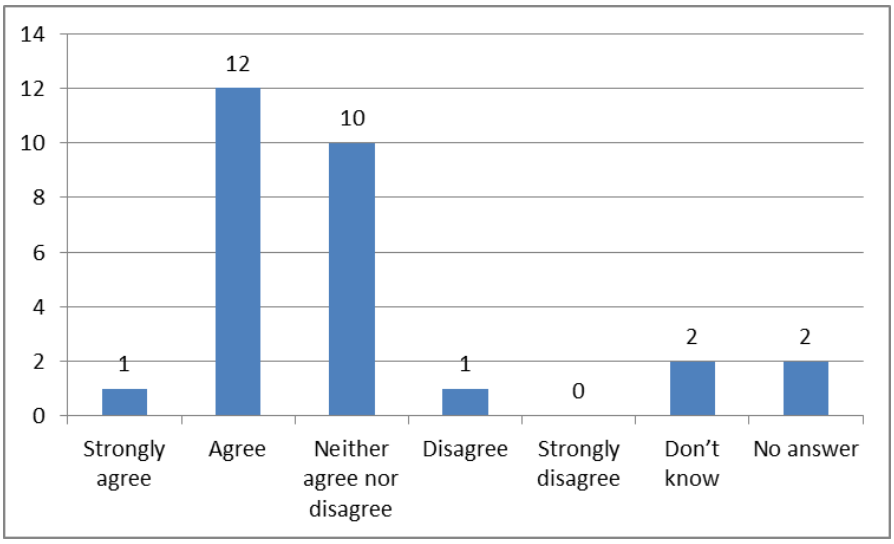
As Figure 26 shows, when the Member States were asked about the provisions surrounding reduced rates for other fermented beverages, they provided responses that were similar to those they gave for wine.

The 13 Member States (strongly) agreeing that the limits for other fermented beverages were appropriate (BG, DK, EE, ES, FI, HU, LT, LU, LV, NL, RO, SE, UK) argued that the reduced rates could lead to **increased production and sales of alcohol with low alcoholic strength** which might benefit consumer health, and that the current **limit should not be expanded**.

The Member States which indicated that they neither agreed nor disagreed with the level below which reduced rates for other fermented beverages could be applied did not apply such reductions; nor did the Member State which indicated that it disagreed (MT).

[60] Member States for which other fermented still beverages are zero-rated are marked as "n/a" in this column; however, please note that some of them may apply a positive rate to sparkling "other fermented beverages".

**Figure 26:** ***The limit below which Member States may apply reduced rates for other fermented beverages (still and sparkling "other fermented beverages" of an actual alcoholic strength not exceeding 8.5% by volume) is appropriate***




*Source: Survey to Member States*

Similarly to the answers regarding reduced rates for wine, a large proportion of the economic operators responding indicated that they neither agreed nor disagreed with the reduced rates for other fermented beverages below a certain alcoholic strength, or they stated that the question was not applicable to them.

Among those that gave an opinion, a tendency towards approving of the provisions for reduced rates was observed. The share of producers[61] of other fermented beverages expressing (strong) satisfaction with the reduced rates was 30%, while a quarter of the producers of other fermented beverages who responded noted that they (strongly) disagreed with the level of the reduced rates.

Only eight trade associations representing producers of other fermented beverages responded to the question about the appropriateness of the reduced rates applying to other fermented beverages below a certain alcoholic strength. Five of these (strongly) disagreed that the reduced rates were appropriate.

In the light of the classification issues reported in detail in Section 2, and in particular the findings relating to the perceived abuse of this category with certain products considered "difficult to classify", the **relatively high threshold** (8.5%) for this category may, in addition to providing its intended support for low-strength "other fermented beverages", inadvertently give further support to products which some respondents feel abuse the already-lower rates of this excise category. On the other hand, for reasons of competition there may also be an argument for maintaining an equivalence between the provisions applicable to wine that are similar to those which are applicable to this category.

### 3.3.5 Intermediate products not exceeding 15%

As Table 12 shows, most Member States have not taken up the option of applying a reduced rate for intermediate products below 15%.

[61] Producers of other fermented beverages only; N=20

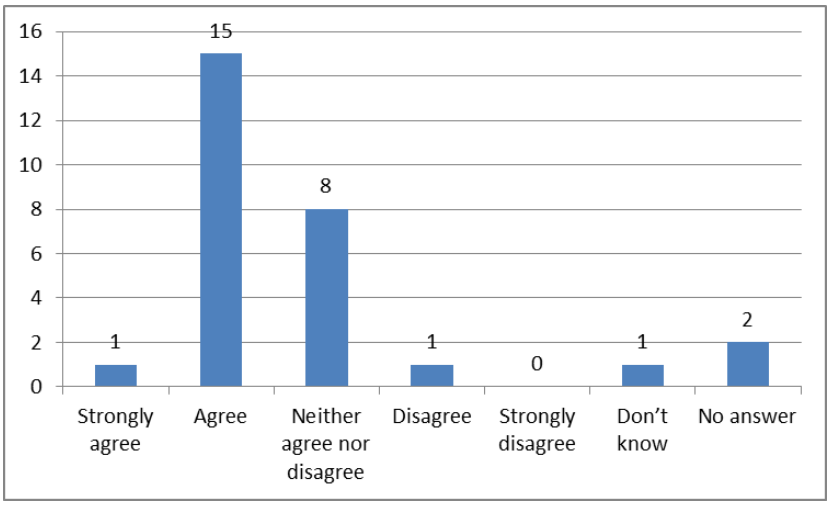
**Table 12: Overview of the implementation of reduced rates for intermediate products below 15%**

| Member State | Reduced rate below 15% | Details |
|---|---|---|
| AT | X | |
| BE | √ | |
| BG | X | |
| CY | X | |
| CZ | X | |
| DE | √ | Reduced rates below 15% |
| DK | √ | Reduced rate below 15% with one intermediate threshold |
| EE | X | |
| EL | X | |
| ES | √ | Reduced rate below 15% |
| FI | √ | Reduced rate below 15% |
| FR | X | |
| HR | X | |
| HU | X | |
| IE | √ | Reduced rate below 15% (only still) |
| IT | X | |
| LT | √ | Reduced rate below 15% |
| LU | √ | Reduced rate below 15% |
| LV | √ | Reduced rate below 15% |
| MT | X | |
| NL | √ | Reduced rate below 15% (only still) |
| PL | X | |
| PT | X | |
| RO | X | |
| SE | √ | Reduced rate below 15% |
| SI | X | |
| SK | X | |
| UK | √ | Reduced rate below 15% |

In the context of the survey, a majority of the Member States indicated that they found the limit below which reduced rates for intermediate products can be applied to be appropriate. These Member States indicated that the reduced rates might **incentivise the consumption of products with a lower strength**, hence with less harmful alcohol content. Others noted that they were satisfied because the reduced rates were not causing any problems, and there was no need to expand the limit.

The eight Member States which did not express a strong opinion regarding this question (i.e. they neither agreed nor disagreed – BE, CY, CZ, EL, PL, PT, SI, SK) and the sole Member State which did not find the limit to be appropriate (MT) did not apply the reduced rate for intermediate products below 15%.

**Figure 27:** ***The limit below which Member States may apply reduced rates for intermediate products (an actual alcoholic strength not exceeding 15% by volume) is appropriate***

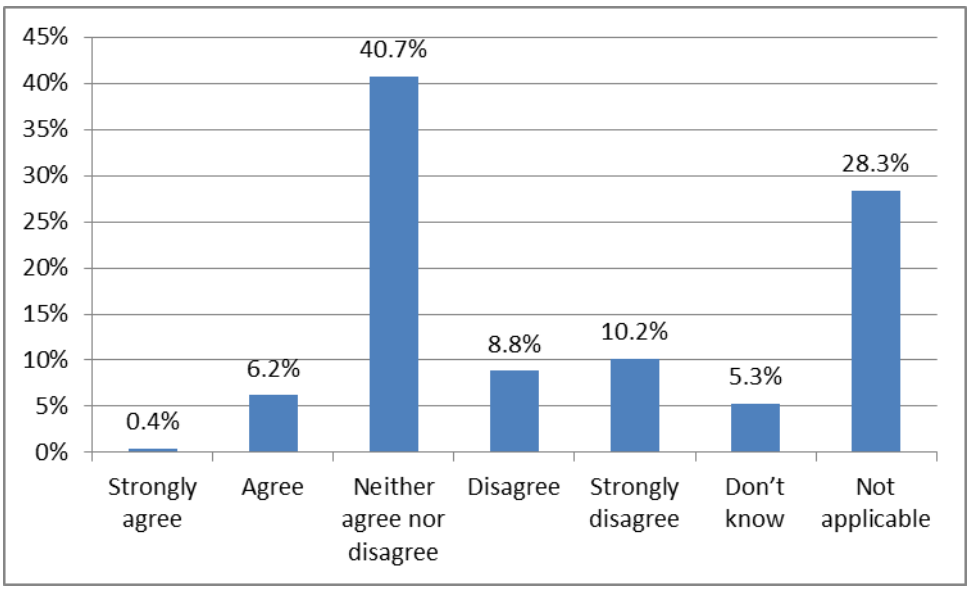



*Source: Survey to Member States*

Among the economic operators, the answers presented in Figure 28 regarding the appropriateness of the provisions for reduced rates for intermediate products resemble those concerning the reduced rates for "other fermented beverages". Most respondents neither agreed nor disagreed, or else indicated that the question was not applicable to them.

The agree / disagree responses for the statement regarding the appropriateness of the limit pertaining to the reduced rates for intermediate products reveal a tendency towards disapproval.

**Figure 28:** ***I find that the limit below which Member States may apply reduced rates for intermediate products (intermediate products with an actual alcoholic strength not exceeding 15% by volume) to be appropriate. (N=226)***




*Source: Survey to economic operators, August-November 2015.*

When only the views of the producers of intermediate products[62] are taken into account, we observe that they are equally distributed between those which consider the current provisions to be appropriate (27%) and those which do not (26%)[63].

[62] Producers of intermediate products only; N=15

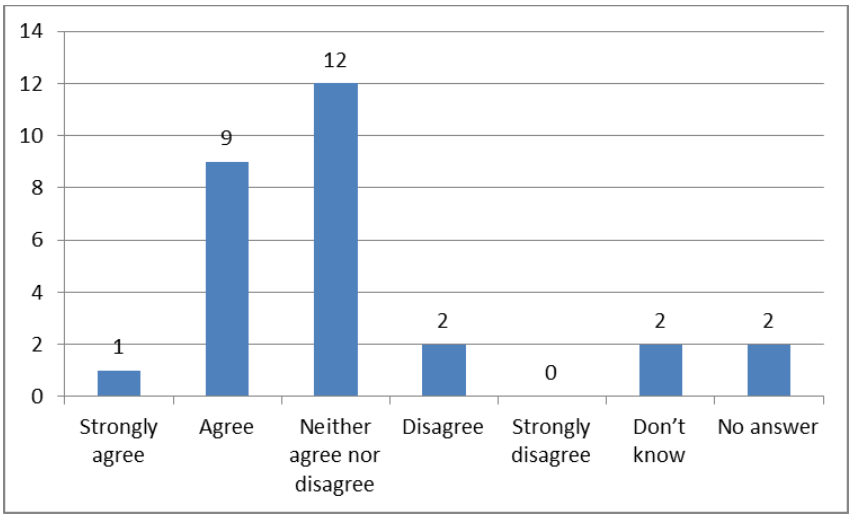
### 3.3.6 Ethyl alcohol not exceeding 10%

Only one Member State (FI) applies a reduced rate for low-strength ethyl alcohol, and does so only for alcohol below 2.8%.

In the survey responses, agreement on the appropriateness of the limit below which Member States may apply reduced rates for ethyl alcohol was less strong than for the limit for intermediate products. The ten Member States which indicated that they considered the limit appropriate (BG, DK, EE, ES, FI, LT, LU, NL, RO, UK) argued that the reduced rate could **incentivise the production and consumption of products of lower alcoholic strength**. The authorities also indicated that they were **unaware of any issues** with the rate.

Those that did not express a strong opinion on this question (i.e. they neither agreed nor disagreed) mostly did not apply the reduced rate. However, two of the Member States which neither agreed nor disagreed noted that the **reduction was superfluous,** as the taxation of ethyl alcohol is already based on alcoholic strength, thereby creating a lower rate for less strong products by design (HU, SE). The two Member States which reported that they did not find the reduced rate appropriate were not applying it (MT, SK). One of them noted that they would prefer a **removal of the provision** (SK).

**Figure 29:** ***The limit below which Member States may apply reduced rates for ethyl alcohol (an actual alcoholic strength not exceeding 10% by volume) is appropriate***




*Source: Questionnaire to Member States*

Most producers of alcoholic beverages and their trade associations did not express a strong opinion on the limits for reduced rates which apply to ethyl alcohol below a certain alcoholic strength. However, the share of respondents (strongly) disagreeing that the reduced rates were appropriate was much higher than the number of those (strongly) agreeing.

Sprits producers[64] expressed **dissatisfaction with the reduced rates for ethyl alcohol** of a lower alcoholic strength. Over 50% of the producers of spirits reported that they did not consider the limits below which Member States may apply reduced rates for ethyl alcohol to be appropriate. Only 10% of respondents agreed that these reduced rates are appropriate.

Among the 19 trade associations representing spirits producers, satisfaction with the limits for reduced rates for ethyl alcohol of a lower alcoholic strength was slightly higher than among the producers themselves. Nevertheless, the share of trade associations

[63] The rest of the respondents neither agreed or disagreed, or answered that reduced rates of this type did not apply to them.
[64] Producers of spirits only; N=31

(strongly) disagreeing that the limit for the reduced rates was appropriate was almost twice as big as the share of those (strongly) agreeing.

## 3.4 Provisions applying only to particular Member States

For certain products from some Member States, reduced rates or exemptions can be applied. These are as follows:

- Reduced rates for some rum products from France (Article 23.1)
- Reduced rates for ouzo from Greece (Article 23.2)
- The classification of wines from certain Spanish regions to which alcohol has been added to a low percentage as wines rather than as intermediate products (Article 24.2)
- Exemptions for dark ales and aromatic bitters from the UK (Article 28).

This evaluation has analysed the continued relevance of these provisions for the Member States concerned. The results are described below.

**Reinforced by the provisions of Article 349 of the Lisbon Treaty, France continues to makes use of the Article 23.1 provision**. The authorities of this Member State argued that they were supporting the local economies of their overseas departments. The reduced rate offsets the higher production costs for rum produced in the overseas departments compared with rum produced by third countries outside the EU, hence the provision remains relevant.

An analysis of trade data for rum imported by France from its overseas departments (i.e. French Guiana, Guadeloupe and Martinique), has been conducted. While the data available are not comprehensive, and are, indeed, somewhat contradictory, the analysis shows that the volumes being imported into France from these territories accounts for a very small proportion of total consumption in France, and therefore, the presence of the reduced rate is unlikely to be creating competitive distortions in the French rum market.

**Greece still makes use of the Article 23.2 provision,** which allows the application of a reduced rate for ouzo (an aniseed-flavoured spirit), and argues that the provision remains relevant.

**The UK no longer invokes the Article 28 exemption**. This Member State's authorities explained that these exemptions were withdrawn from UK legislation on 1 April 2013, following a review of tax reliefs. Accordingly, the provision has lost its relevance, as it is no longer appropriate to the needs of the UK.

## 3.5 Exemptions for private production intended for own consumption

In this section, we discuss the exemptions and reduced rates for private production for own consumption. The relevance and effectiveness of these provisions is assessed. An extension of the exemption to intermediate products and spirits is discussed.

Articles 6, 10 and 14 provide for exemptions of the excise duty that would otherwise be levied on beer, wine and other fermented beverages "produced by a private individual and consumed by the producer, members of his family or his guests, provided that no sale is involved"[65].

A mapping of the current state of affairs across the Member States reveals that more than half the Member States have applied these exemptions. Where such exemptions are applied, there are a few cases which make distinctions between exemptions for beer, wine or other fermented beverages, though their exemptions usually cover all three categories in the same way.

[65] Article 6, Directive 92/83/EEC

The perceptions of the national authorities differ significantly regarding what they consider to be the desirable course of action at the EU level and the expected implications of any changes. Additionally, some Member States have expressed an interest in expanding the exemptions to include intermediate products and ethyl alcohol, for which the Directive does not currently grant exemptions.

This section provides some insights into the suitability of the existing exemption (considering also the use and purpose of reduced rates on the private production of "ethyl alcohol" by fruit growers), with a view to making recommendations about how the situation could be improved. This will involve considering whether the exemptions should be expanded to include intermediate products and ethyl alcohol.

The countries which are currently implementing reduced rates for the production of ethyl alcohol by fruit growers are Bulgaria, the Czech Republic, Hungary, Romania and Slovakia. The rationale is their tradition of producing such drinks, as well as the view that imposing high excise duties could incentivise illegal production.

Following the EU enlargements in 2004 and 2007, the Directive was amended to include Articles 22(6) and 22(7). These allow Bulgaria, the Czech Republic, Hungary, Romania and Slovakia to apply reduced rates to ethyl alcohol produced by fruit growers' distilleries for own consumption. The reduced rate is set at not less than 50% of the national rate for ethyl alcohol, and can only be applied to distilleries producing more than 10 hectolitres of alcohol from fruit supplied by the fruit growers' households. The reduced rate is limited to 30[66] / 50[67] litres of fruit spirits annually per producing fruit grower's household, and must be destined exclusively for their personal consumption.

### 3.5.1 Ethyl alcohol produced by fruit growers for their own consumption

Bulgaria, the Czech Republic, Hungary, Romania and Slovakia all reported that they continue to make use of the provisions regarding the reduced rates for ethyl alcohol produced by fruit growers.

The Member States in question highlighted the **continued relevance** of these provisions by pointing out several policy objectives they wish to pursue: the authorities of two Member States (BG, CZ) referred to the **tradition of ethyl alcohol production by fruit growers**. Another Member State (HU) mentioned the social need for this use of fruit that would otherwise go to waste, emphasising that the existence of this provision allows **adequate monitoring and control to be implemented**. As 10,000 fruit growers are registered to produce their own spirit in Hungary, its authorities predict that this production would go underground rather than disappear if the reduced rate was restricted or abolished. Two Member States (CZ, SK) underlined that it was fully possible to control the application of the provision, and that the limits provided corresponded to the needs of the fruit growers.

### 3.5.2 Experience of Member States with exemptions for the private production of alcohol for own consumption

In the majority of cases, Member States which have applied the current exemptions on beer, wine and other fermented beverages have made **no severely negative experiences** with the current provisions. In terms of the **administrative costs** that arise from applying such exemptions, some countries find that these **are minimal** if the private production of beer, wine and other fermented beverages is not very common or prevalent. Nevertheless, even in countries like Hungary where private production is more popular, the authorities take the view that excise duty exemptions on private production for own consumption generally reduce administrative burdens rather than increasing them.

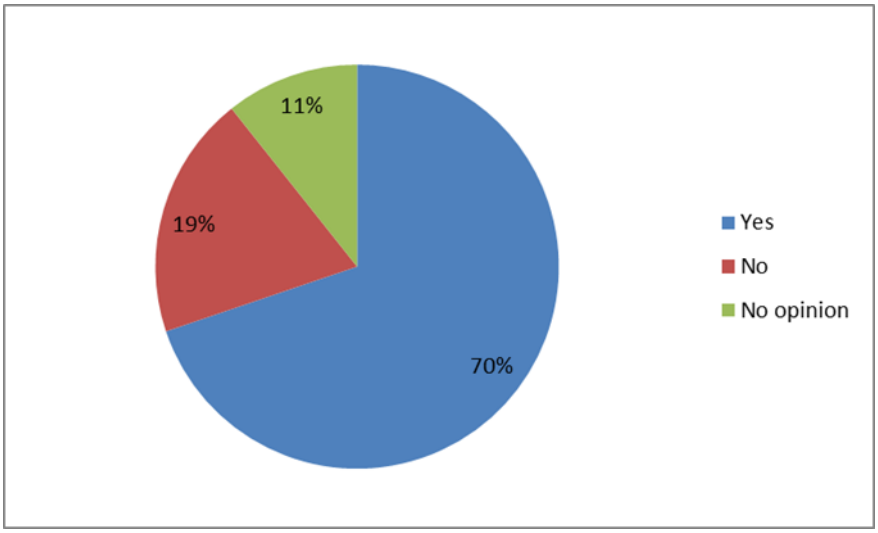
[66] BG, CZ
[67] HU, RO, SK

Regarding fraud, Hungarian authorities expressed the opinion that excessively complicated administration and a high burden of excise duty pushes private individuals towards illegal production. Therefore it is likely that the application of the current exemptions has not had a large impact on fraud levels, and has in fact prevented widespread illegal production.

Member States which have not applied exemptions to beer, wine and other fermented beverages are worried that the application of such exemptions, as well as their expansion to cover intermediate products and ethyl alcohol, would lead to **increased spill-over fraudulent activity**. It is argued that this also has cross-border effects, particularly with neighbouring Member States which have applied the current exemptions.

A majority of respondents to the open public consultation indicated that they were aware of exemptions for private production and own consumption in the categories of beer, wine and fermented beverages, whereas 19% of the respondents reported being unaware of them (primarily citizens, tax advisors and SMEs).

**Figure 30: *Are you aware of this exemption in these categories?* [exemptions of private production of beer, wine and other fermented beverages for own consumption] (N=159)**



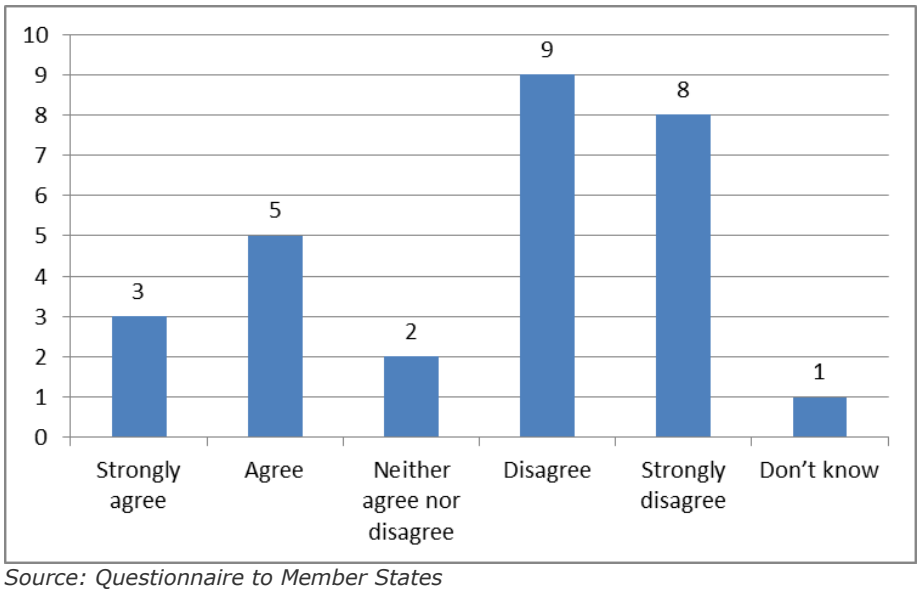

*Source: Open public consultation, August to November 2015*

A quarter of the respondents noted that they were in favour of extending the exemption for own production to all the product categories (large shares of participating citizens, tax advisors and European associations). Half of the respondents opposed such a suggestion (companies of different sizes, their associations and NGOs) as they thought that an extension of the exemption provisions would encourage the fraudulent production and sale of ethyl alcohol, and might even inspire cross-border activity. By contrast, 22% of the respondents (mainly consumers, academics and SMEs) indicated that they did not think fraudulent activity could be encouraged by more exemptions for own production, while 30% had no opinion on the subject.

### 3.5.3 Opinions of Member States regarding the appropriateness of current provisions

Some Member States put forward **proposals to extend the exemptions** in the light of their perceived national circumstances. These included ideas to prevent fraud through potential registration measures that could be put in place if exemptions were extended to cover intermediate products and ethyl alcohol. Member States opposing the idea of expanding the exemptions have not suggested major changes to the situation.

**Figure 31:** ***Exemptions for private production intended for own consumption should be established for intermediate products and ethyl alcohol***




*Source: Questionnaire to Member States*

When asked whether exemptions for private production intended for own consumption should be established for intermediate products and ethyl alcohol, six[68] Member States were in agreement, 17[69] Member States disagreed, and three Member States[70] were indifferent to the proposition. The Member States which disagreed with expanding the exemptions gave as their main reasons the perceived health risks, reduced tax income, worries about (cross-border) fraud, increased administrative costs, and the difficulty of preventing the abuse of exemptions.

The countries which agreed with expanding the exemptions gave as some of their main reasons minimising administrative burdens and costs, their own national sovereignty, maintaining traditional lifestyles and culture, and curbing illegal activity by bringing it under customs supervision. (These arguments are discussed further in Section 3.5.4.)

Among the proposals put forward to amend the current provisions, the authorities in Luxembourg, which are in favour of extending the exemptions, stated that in order to reduce the risk of fraud, they currently register those small producers who produce beer, wine and other fermented beverages for their own consumption. As a result, extensions of exemptions could include a requirement for the registration of small producers; the Hungarian authorities also mentioned potentially obliging individuals to notify them online when undertaking private production. Slovenian authorities suggested that if a limit for the private production intended for own consumption is set at a suitably low quantity (30-50 litres of alcohol per year), then there is little risk of fraud.

In addition to this, one suggestion made by the UK authorities is to allow Member States the flexibility to provide exemptions for any home-produced alcohol to reflect their own national circumstances. Belgian officials also mentioned that the extent to which exemptions are possible will depend on the customs and traditions of the country in question. This speaks to the importance of allowing for heterogeneity across Member States when considering changes to the current provisions. This point is reinforced by the fact that in some countries, traditional home-made spirits and production methods are an important part of the culture. Nevertheless, the risk of cross-border fraud needs to be taken into account in this connection.

[68] HU, PT, SI, BG, LU, UK
[69] CZ, DK, EE, FR, HU, IT, LT, LV, PL, AT, ES, FI, IE, MT, NL, SE, SK
[70] BE, CY, DE

Finally, the Hungarian officials stated that the risk of illegal trade could be eliminated by controlling commercial channels and catering services. The risk of illegal activity in this area would remain the same regardless whether or not private production of own consumption is permitted.

### 3.5.4 Likely effects of the expanding the exemption for private production

The dominant opinion from the Member States was that an expansion of the exemption to intermediate products and ethyl alcohol would increase the risk of fraudulent production and sale of these products, and would potentially spill across borders. A small minority of Member States believe that such negative effects would not occur, taking the view that expanding the exemptions would actually reduce fraud by bringing private production under the regulatory fold.

As expected, the majority of countries which were in agreement with extending the scope of exemptions either believed that such expansions would not increase the risk of (cross-border) fraudulent production and sale of intermediate products and ethyl alcohol, or were neutral regarding this idea (HU, PT, SI, LUX, UK).

Regarding the Member States which disagreed with the suggestion that expanding the exemptions would increase the risk of fraud, one of the reasons they gave was that expanding exemptions would in fact **bring this production into the purview of customs controls**, which would only contribute to reducing fraud rather than increasing it (PT). The Hungarian authorities echoed this point, stating that the illegal trade in such products would occur regardless of whether the exemptions are expanded, and that the risk of illegal trade can be eliminated by controlling commercial channels and catering services. As has also been mentioned previously, the Slovenian officials were of the view that if the limit for private production for own consumption is set at an appropriately low quantity, there will be no risk of the fraudulent production or sale of these products.

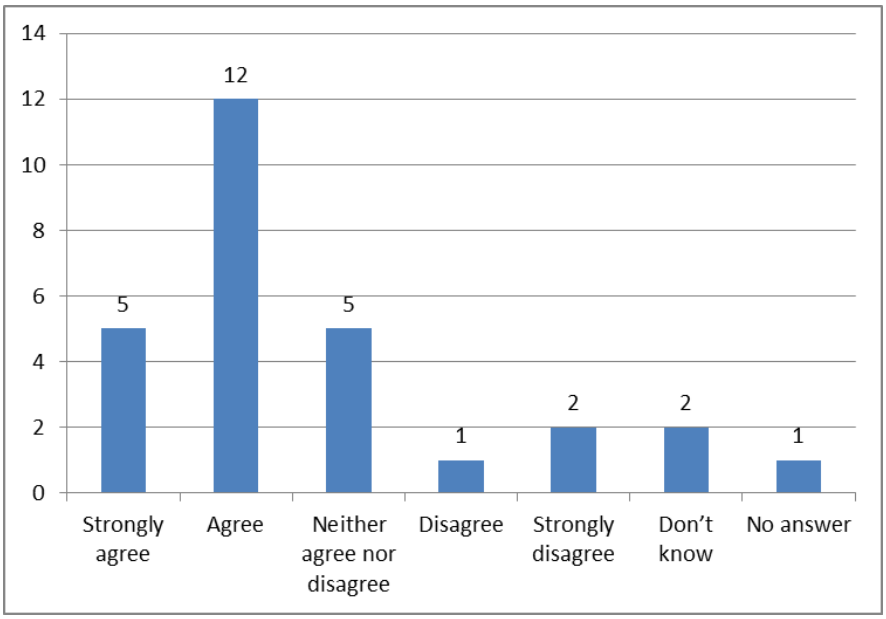
The main other potentially positive effect from increasing the scope of the exemptions to cover intermediate goods and ethyl alcohol is the **preservation of traditional methods of production**. In all the Member States, the distillation of alcohol for private production and own consumption must normally take place in a tax warehouse. In practice, this means that individuals end up purchasing industrially produced ethyl alcohol as opposed to distilling it themselves, which is argued to be causing the loss of traditional methods of production.

Some of the Member States (BG, HU, SI) which favour extending the exemptions (and two of which are currently applying the reduced rates to ethyl alcohol produced by fruit growers) mentioned the important tradition of home-made spirits in their national culture. It was also suggested by the Hungarian authorities that cutting back any of these exemptions or reduced rates would significantly increase the degree of illegal home distilling, as a high excise duty burden pushes private individuals towards illegal production.

Despite this, 17 Member States[71] believe that such expansions would **lead to increased fraud**. They believe that expanding the exemptions would increase the risk of the fraudulent production and sale of intermediate products, and could eventually have a cross-border effect, due to the high tax rates levied on these products. They thought the expansion would lead to a higher risk of tax evasion (LT, EE). Currently, the excise duty rates for intermediate products are relatively high in every Member State, and so the benefits and temptations connected with the fraudulent production and sale of such products are correspondingly greater.

[71] AT; CY; ES; IE; MT; BG; CZ; DE; EE; FI; IT; LT; LV; NL; PL; SE; SK

**Figure 32:** ***An expansion of the exemption to intermediate products and ethyl alcohol would increase the risk of fraudulent production and sale of these products, and could eventually have a cross-border effect***




*Source: Questionnaire to Member States*

Another potential negative effect mentioned by the Austrian authorities would be the **increase in administrative costs and decrease in tax income**. It is believed that an extension of exemptions would be difficult to manage and control, which would mean additional administrative costs. Several countries stated that it would be very difficult from a tax administration's viewpoint to control the additional risks associated with providing an exemption for private production and proving any abuses of exemption. It was mentioned that the differences in excise duty rates are already being exploited currently, and that such an exemption would incentivise even greater cross-border fraud. Therefore, it is believed that the aim of applying tax exemptions is closely tied to more complex processes of tax administration and potential tax evasion cases, and that this should be taken into account when considering any expansion of the provisions.

By contrast, the Hungarian officials stated that the taxation of fruit spirits produced by fruit growers or tax warehouses in small quantities for the fruit growers' own consumption confers more disadvantages than advantages. This is because such small quantities per household entail small excise duty amounts, and therefore small budget revenues. It was suggested that the collection of such excise duties and the monitoring of compliance with such rules is costly compared with the yield of excise duty revenue. This leads to an excessive administrative burden, which in turn pushes private individuals towards illegal production. By contrast, extending the exemptions for private production for own consumption could have the benefit of reducing the administrative burden.

**Health risks** were also commonly mentioned as a negative consequence of expanding exemptions (EE, IE, MT, SK and CZ). It was stated that there would be a high potential for abuse to lead to greater health risks, and therefore the production of ethyl alcohol and intermediate products should be controlled and taxed.

# 4. Provisions concerning the exemption of denatured alcohol

This chapter deals with the implementation and functioning of the provisions for the exemption of denatured alcohol. They are assessed in terms of the extent to which they are able to ensure the functioning of the internal market and allow for fair competition between economic operators. A further objective of the provisions was to identify potential ways to reduce fraud risks. However, this objective has been dealt with separately in Chapter 5.

Article 27 of the Directive allows for the exemption from excise duty of denatured alcohol.

Under Article 27.1 (a) of the Directive "*alcohol which has been completely denatured in accordance with the requirements of any Member State*" shall be exempted from the application of excise duty. The requirements for those exemptions are to be notified to the Commission and shared with the other Member States under the procedure provided for in Articles 27.3 to 27.5. The recognised denaturing procedures are listed in Commission Implementing Regulation No 162/2013.[72]

Article 27.1 (b) stipulates that alcohol that is "*denatured in accordance with the requirements of any Member State and used for the manufacture of any product not for human consumption*" may equally be exempted.

At the beginning of this chapter, we will assess the relevance of these provisions. Because the application of the provisions is characterised by significant inconsistencies across the Member States (a situation illustrated in sub-section 4.3), we assess the impact of the provisions on competition between economic operators, as well as of the potential reductions in administrative burdens and costs. Consequently, the added value of setting rules for the exemption of denatured alcohol at the EU level is assessed. Finally, Section 4.7 presents potential solutions to the issues presented.

We would like to remind readers of the limited representativeness of the responses to the survey presented to economic operators in the area of denatured alcohol. The number of respondents was much lower than for the other areas (less than 50 respondents). Specifically, the questions regarding exemptions under Article 27.1 (b) were answered almost exclusively by respondents from the cosmetics sector, which strongly aligned their answers, in some instances to the point of being identical. Therefore we cannot consider the answers relating to the functioning of Article 27.1 (b) as representative of all "*producers and users of alcohol exempt under Article 27.1 (b)*". However, survey data covering either both Articles or Article 27.1 (a) only were not affected by this overrepresentation, and hence were used, with caution, for analytical purposes.

An in-depth case study was conducted to examine issues which were identified in the first round of data collection, in order to understand the impact on economic operators and the origin of the issues, as well as indicating potential solutions. The case study also helped to mitigate the survey's data limitations, as we ensured that the collection of data from the producers and users of denatured alcohol from different sectors was balanced. The case study report can be found in Appendix 8 – *In-depth case study on the management of exemptions for denatured alcohol*.

## 4.1 Summary of findings

**While the basic need for clear common rules for the exemption of denatured alcohol continues to exist and underscores the relevance of the provisions, in its current form Article 27 is not meeting its objectives.** Articles 27.1 (a) and (b) lack

[72] Amending Commission Regulation 3199/93

clarity regarding which products can be exempted under what conditions. This was also reported by Member States as their main reason for considering that the Articles are not meeting the needs of their administrations. The mechanism described in Article 27.5 has responded to the needs of Member States in the past. However, it is little used considering the cases of fraud known to the authorities. The mechanism could be revised to make the procedure less time-consuming and more easily accessible, while ensuring that the consequences of its use remain proportional to the risk of fraud resulting from the abuse of the denaturing method in question.

**The absence of clarity of Article 27.1 (a) with regard to what mutual recognition of denaturing methods should entail is leading to significant inconsistencies in the treatment of exemptions of completely denatured alcohol across the Member States**. Exemption requirements vary across the Member States in terms of whether the denaturing must take place in the country in question, or whether the denatured alcohol comes from another Member State or is imported from outside the EU. No common approach is being applied across the Member States.

**The scope of Article 27.1 (b) is not clearly identified in the Directive, which is leading to strongly divergent conditions for receiving this exemption across the Member States.** The main issues are connected with the differing interpretations of the term "used for the manufacture of any product not for human consumption". A potentially endless number of denaturing methods can be used for very different types of product.

**These inconsistencies create significant uncertainties regarding whether exemptions will be granted, and hence generate significant financial and commercial risks for producers and users of denatured alcohol**. The issues identified can affect economic operators' decisions about where to set up production or where to purchase denatured alcohol, and can hinder the free movement of goods. The analysis has also shown that there are several situations in which – theoretically at least – economic operators of one Member State have a competitive advantage over those from other Member States. Overall, price is not an important factor for competition; however, the relatively high price of the Eurodenaturant was mentioned.

**Administrative burdens and costs for Member States and economic operators could be reduced by ensuring a common understanding of the provisions, and by increasing harmonisation**. Economic operators specifically mentioned that using the Eurodenaturant in its current composition generated unnecessary costs.

**Considering the problems stemming from a lack of a common EU approach, a clear added value from regulating the exemption of denatured alcohol at the EU level can be identified.** While the added value of having Article 27 to set rules at the EU level can be questioned because of its inadequate clarity and the Member States' varying and often contradictory interpretations of the exemption provisions, the current problems also show that a stronger common approach is needed. This was confirmed by those stakeholders who expressed support for action at the EU level but pointed to the flaws that exist in the current system, whose rules are unclear and are interpreted differently by the various Member States.

## 4.2 Relevance of the system for the recognition and management of exemptions for denatured alcohol

This section presents our findings and conclusions with regard to whether Articles 27.1 (a) and (b), as well as Article 27.5, still correspond to the needs of the Member States and its economic operators.

### 4.2.1 Relevance of Articles 27.1 (a) and (b)

The provisions regarding the exemption of denatured alcohol were created with the aim of excluding from the application of excise duty alcohol that is not consumed but is used for industrial purposes. The objectives of these provisions of ensuring fair competition

between economic operators and providing a clear framework for a functioning internal market **continue to be highly relevant**.

In practice, however, the inadequate clarity of Articles 27.1 (a) and (b) challenges their relevance, as the Member States have to find individual solutions and interpretations. While a majority of the Member States reported that Article 27.1 (a) still corresponded to their needs (see Figure 33), less than half of the Member States noted the same for Article 27.1 (b) (see Figure 34).

**Figure 33:** ***The needs of my administration in terms of the exemption of completely denatured alcohol as understood under Article 27.1 (a) are met by the provisions of the Directive.***

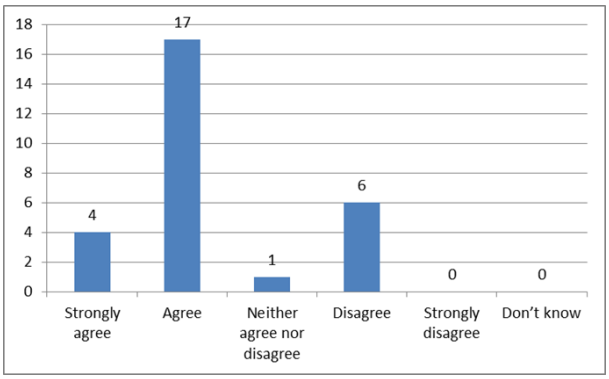
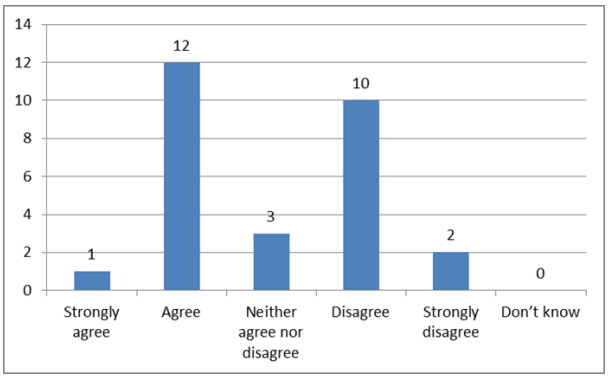



**Figure 34:** ***The needs of my administration in terms of the exemption of denatured alcohol as understood under Article 27.1 (b) are met by the provisions of the Directive.***




*Source: Questionnaire to Member States*

With regard to Article 27.1 (a), six Member States[73] indicated that their needs were not being met, thus highlighting **significant issues with the interpretation of the Article**. The Article does not clearly state whether a Member State can only accept the denaturing method it has itself notified to the Commission, whether the methods of other Member States can be employed, and whether only a method used by the Member State which notified it can be recognised (e.g. Can Member State A recognise denatured alcohol coming from Member State B denatured with a formula notified to the Commission by Member State C?). The latter would require the Member States to verify where a product was put into circulation. These six Member States were in agreement regarding the need to clarify the wording of the Directive.

With regard to the exemption of denatured alcohol under Article 27.1 (b), 12 Member States[74] indicated that the needs of their administrations were not being met. The explanations of these Member States show that the **confusion surrounding the exemption** under Article 27.1 (b) is even greater than for completely denatured alcohol.

They considered the wording of the Article to be inadequate, leading to an absence of uniformity in the interpretation of the exemptions. This includes the unclear definition of the different terms used in the Article, e.g. "not for human consumption", "product" and "used for the manufacture of", which leads to diverging interpretations about which products the Article is actually referring to and how these products should be treated.

### 4.2.2 The legal mechanism provided in Articles 27.5

If a Member State finds that a product which has been exempted from excise duty as denatured alcohol (under Article 27.1 (a) or (b)) gives rise to evasion, avoidance or abuse, it may refuse to grant exemption or withdraw the relief granted (Article 27.5).

[73] AT, BE, FI, NL, PL, SE
[74] AT, BE, CZ, DE, EE, FI, LT, NL, PL, SE, SK, UK

The Member States reported that this **mechanism is rarely used**. Only three of them stated that they had done so. While they all reported that the procedure had led to an agreement which was acceptable to all parties and prevented subsequent fraud, it was also noted that the procedure was rather cumbersome and time-consuming.

Among the Member States as a whole, several mentioned that they had not come across any fraud involving denatured alcohol that would have required the use of the provision. Others said that in practice it was difficult to prove that a specific denaturing method had given rise to evasion or abuse. Often it would be difficult or even impossible to identify which denaturing method had been used, as the fraudsters would try to remove the denaturants to render the alcohol drinkable. Some Member States do not systematically test illicit alcohol seized by them, and thus would not be aware of whether it had originated from fraud involving denatured alcohol. Three Member States suggested **changing the wording of the Article** to allow them also to respond to cases where only a **strong suspicion of fraud** exists concerning a particular denaturing method, rather than a proven instance.

## 4.3 Applicable conditions for the exemption of denatured alcohol

As the findings of the previous section have demonstrated, there are a number of issues surrounding the application of exemptions which the Member States and economic operators consulted consider to be linked to the Directive's absence of clarity. In this section, the differences in the application of exemptions under Article 27.1 (a) and (b) are presented, highlighting the reasons for the variability of the interpretations. It is this **fundamental lack of clarity** which is creating the ambiguities for both Member States and economic operators regarding Articles 27.1 (a) and (b). Additionally, the lack of clarity between the holding and movement provisions in Directive 2008/118/EEC and the application of either (a) or (b) is creating single-market distortions and competition issues, as Section 4.4 explains.

### 4.3.1 Article 27.1 (a)

Article 27.1 (a) foresees that Member States will notify their denaturing methods for complete denaturation to the Commission. Regulation 162/2013[75] lists these denaturing formulations. The majority of Member States have at least one national denaturing method listed in the Regulation, while nine Member States have abolished their national methods and only use a "*denaturing procedure employed in all Member States*", also known as the Eurodenaturant[76]. This denaturing method was introduced under Regulation 162/2013.

Regulation 162/2013 refers in its title to the "*mutual recognition for procedures for complete denaturing of alcohol*". In theory, the system of mutual recognition allows for the exemption of denatured alcohol produced using another Member State's denaturing formulation. In practice, the extent to which this is possible, and the conditions that apply, varies across the Member States.

In the context of the evaluation, the Member States were asked to explain which denaturing methods they recognised in the context of the following three conditions:

- when denatured alcohol is produced in the Member State concerned;
- when denatured alcohol is produced in a different Member State and then moved to the country concerned; and
- when denatured alcohol is imported from outside the EU.

A summary table of the responses is provided in the case study in Appendix 8 – *In-depth case study on the management of exemptions for denatured alcohol*.

[75] Commission Implementing Regulation 162/2013 of 21 February 2013 amending the Annex to Regulation (EC) No 3199/93 on the mutual recognition of procedures for the complete denaturing of alcohol for the purpose of exemption from excise duty.
[76] The Eurodenaturant is composed of 3 litres isopropyl alcohol (IPA), 3 litres methyl ethyl ketone (MEK) and 1 gram denatonium benzoate per hectolitre of absolute alcohol.

For **production on their own territory**, most Member States indicated that they accept the method they had noted under Regulation 162/2013 plus the Eurodenaturant, or the Eurodenaturant alone where there was no national method. Five Member States noted that they recognised any denaturing method notified under Regulation 162/2013 when alcohol is denatured in their own country. In addition, there are three Member States which still have their own denaturing method listed in Regulation 162/2013, but which indicated in the questionnaire that they recognise only the Eurodenaturant for total denaturation.

The variability in interpreting the provisions for completely denatured alcohol becomes even more significant in a comparison of the **conditions for moving completely denatured alcohol from one Member State to another**. The question is whether any of the methods specified under Regulation 162/2013 can be used, or only the one recognised by the Member State in which the alcohol was produced.

Ten Member States specifically stated that they would only recognise a method authorised by the Member State of origin of the denatured alcohol. This means, for example (following the information provided by the Member States and presented in Table 1 in Appendix 8), that denatured alcohol from Slovakia using Germany's recognised method of complete denaturation would not be recognised as a completely denatured alcohol in Romania. Instead, the alcohol could only be exempted under Article 27.1 (b), and would therefore have to be moved under the cover of an e-AD.

> *"Complete denaturing depends on the Member State in which denaturation has taken place and whether the denaturant used has been authorised for this Member State under Regulation 3199/93* [now Regulation 162/2013]*."*
> German tax authorities

Contradicting this interpretation, nine Member States suggested that producers from other Member States selling completely denatured alcohol to that country would be able to choose from all the different formulations notified under the Regulation. Two Member States indicated that when denatured alcohol is produced in another Member State and then moved to their country, only their own national denaturing method or the Eurodenaturant can be used, whereas the denaturing method of the country of production would not be recognised for complete denaturation.

When **denatured alcohol arrives from third countries,** most Member States request the use of the same denaturing methods that apply to national producers. This procedure is mentioned in the minutes of a meeting of the Committee on Excise Duty held in 2014. The minutes state, *"in the case of importation and clearance for free circulation it is the Member State of importation who has to monitor that the denaturing has been properly done in accordance with the rules of the Member State of importation. All other Member States are dependent on the decisions of the Member State of importation"*[77].

> *"For alcohol introduced from a third country which is to be completely denatured in one of the Member States, the same conditions apply with regard to the denaturants as to the producers from that Member State where the denatured alcohol will be released into free circulation."*
> German tax authorities

However, seven Member States indicated that operators from third countries can use <u>any</u> of the denaturing methods listed in the Regulation for complete denaturation, whereas national producers can only use the method listed by their country. By contrast, there are also two Member States where local producers have a greater choice of methods for complete denaturation, while the denaturing methods for alcohol from third countries are limited to the national formulation and/or the Eurodenaturant.

[77] Committee on Excise Duty (2014): Interpretation and application of Commission Regulation (EU) No 162/2013 of 21 February amending the Annex to Regulation (EC) No 3199/93 (CED 846).

While these findings highlight the fact that significant inconsistencies exist regarding the recognition of denaturing methods, the **supervision and movement of completely denatured alcohol** follow very similar requirements in all Member States. A detailed presentation of the requirements for completely denatured alcohol can be found in the case study report contained in Appendix 8 – *In-depth case study on the management of exemptions for denatured alcohol*.

### 4.3.2 Article 27.1 (b)

The primary issue concerning Article 27.1 (b) is the uncertainty regarding its scope. In previous drafts of the Directive, it was intended to cover "*other denatured alcohol for use in perfumes, toiletries and cosmetics or for external medical use*"[78], but today it applies to "*any product not for human consumption*". There is **no clear distinction between Article 27.1 (a) and (b)** other than the mention of the denaturing method to be used. But even this distinction does not apply where the authorities do not recognise another Member State's method for complete denaturation.

For the exemption under Article 27.1 (b), there is no common list of denaturants. Each Member State has laid down in its national legislation which denaturing method is permissible for the purpose of exemption. For the study, the Member States were asked to provide a list of the denaturation methods they recognised for exemption under Article 27.1 (b). This information is presented in Appendix 8 – *In-depth case study on the management of exemptions for denatured alcohol*.

The provisions of the Member States vary regarding the number and indicated purpose of denaturing methods. While some Member States have extremely long lists of denaturants which indicate the specific applications of each one, others have shorter lists of denaturants that are not tied to any particular purpose. The Member States listed the following uses for alcohol denaturing methods that qualify for exemption under Article 27.1 (b):

- Cosmetics and perfumes
- Air fresheners
- Printing inks
- Fuels, in particular bioethanol
- Cleaning products and detergents
- Screen wash.

**This list of potential uses is not exhaustive**. Many Member States, but not all, indicated that their customs authorities can authorise denaturation using additional methods where this is required for the quality of the final product. As described above, alcohol that would be recognised as completely denatured in one Member State can be produced and moved to that country or to another Member State under duty suspension and then be exempted under Article 27.1 (b).

In addition, the interpretation of Article 27.1 (b) varies **when a product can be exempted** due to the wording of the term "not for human consumption". In the light of the uncertainty created by this wording, the Commission's Indirect Tax Expert Group has issued an opinion on the interpretation of the term "*used for the manufacture of any product not for human consumption*". It specified that in order to be exempted from excise duty under this Article, a product needed to be "*in its recognisable finished form, held out for sale in that recognisable finished form and must contain denatured alcohol which has been directly used in its manufacture*"[79].

But not all the Member States followed this interpretation. When they were asked to explain how they understood the term, a majority of the Member States (18) considered

[78] In the initial proposal, all exemptions were combined into a single Article 17. The exemption now found under Article 27.1(b) was then Article 17.1(c).

[79] European Commission, Indirect Tax Expert Group (2014) Opinion 1/2014 – Interpretation of the term "used for the manufacture of any product not intended for human consumption" in Article 27 (1) (b) of Council Directive 92/83/EEC; TAXUD(2014)01009

that the product was not intended to be drunk and/or eaten by humans. Only eight Member States shared the view that the denatured alcohol would have to be used in the manufacture of another product, and that only a final product could therefore be exempted (10 Member States[80]). Two Member States specifically indicated that they did not consider the final form of the product to be decisive for the exemption (IT, NL).

In addition to these differences in interpretation regarding the scope of Article 27.1 (b), the requirements connected with the supervision of production and movement also vary somewhat across the Member States. Currently, denatured alcohol is supervised under the EMCS, while in some circumstances products can move freely. However, the stakeholders did not identify these differences as a cause for concern (see case study report in Appendix 8 – *In-depth case study on the management of exemptions for denatured alcohol*).

A particular case involves alcohol denatured in the Cosmetic sector to produce fragrances and perfumes with the use of special ingredients to prepare the final product. In that sector, the denaturation process is designated as 'in-situ denaturation' and consists in adding essential oils to undenatured alcohol for the production of cosmetics. Cosmetic producers explained that they would denature alcohol through the process of adding the fragrances which would ultimately define their perfume. Such a procedure has no legal basis in EU legislation. In this context the Indirect Tax Expert Group (ITEG) noted in an opinion of 1/2014 that "*it is essential that a denaturing substance was intentionally added to the product at issue*"[81]. Although the producers stated that it was highly unlikely their final products would be diverted in order to make them fit for human consumption due to their high cost, the ITEG recommended that essential oils alone should not be regarded as an adequate denaturant, as their analysis was not common practise amongst Europeans Custom laboratories[82].

Linked to the discussion regarding exemption under Article 27.1 (b) is the question of whether **denatured alcohol used for cleaning machinery and equipment in production processes** can be exempted from excise duty. While this alcohol is denatured and is not being used for human consumption, there could be a risk of abuse when permitting such an exemption in factories where limited surveillance exists.

For economic operators, such an exemption could represent significant cost savings. Users of denatured alcohol would opt for exempting alcohol used in the production process in order to reduce storage space for their products. Overall, the Member States agreed that this alcohol should be exempted. However, they did not agree whether the alcohol used for cleaning purposes would need to be denatured or not. Some of them argued that there was a risk of fraud if the alcohol was not denatured; others suggested that there could be circumstances where non-denatured alcohol would be necessary for cleaning purposes.

## 4.4 Consequences of inconsistent treatment

The consequences of the ambiguity of Article 27 and the differing interpretations by the Member States have an impact on the internal market and the competition between economic operators. These are discussed in the following section.

### 4.4.1 Consequences for the functioning of the internal market

When considering the impact on the internal market of the conditions for denaturing alcohol, it should always be kept in mind that a primary intention for its sometimes complex structures is the reduction of fraud risk. Differences in the perceived risk of fraud

[80] BG, CY, CZ, DK, EL, FR, IE, LU, SK, UK
[81] European Commission, Indirect Tax Expert Group (2014): Partially Denatured Alcohol under Article 27 (1) (b) of Council Directive 92/82/EEC – Cosmetics, perfumes and personal hygiene products; taxud.c2(2014)3274676
[82] European Commission, Indirect Tax Expert Group (2014) Opinion 1/2014 – Interpretation of the term "used for the manufacture of any product not intended for human consumption" in Article 27 (1) (b) of Council Directive 92/83/EEC; TAXUD(2014)01009

involving denatured alcohol to some extent also explain the variations in the conditions. Overall, the Member States reported that they were satisfied with the available means of limiting fraud risks (see also Chapter 5). The following section therefore focuses on the problems experienced by the producers and users of denatured alcohol in relation to the exemption provisions under 27.1 (a) and (b).

The applicable conditions regarding the granting of exemption under Article 27.1 (a) were demonstrably having an impact on the business decisions of producers and users of completely denatured alcohol, and could hinder trade between the Member States.

The differing interpretations of Article 27.1 (a) regarding the extent of mutual recognition create **uncertainty for producers** who want to sell completely denatured alcohol to other Member States. They are not always sure whether a particular method of complete denaturation will be recognised as such by another Member State.

The differences in interpretation can even **obstruct trade**. When not using the Eurodenaturant, in many cases producers have to use their own country's denaturing method. If they want to produce completely denatured alcohol using the formulation recognised in the Member State where their customers are located, they must send the denatured alcohol under duty suspension. This will mean they can only trade with customers who are registered consignees.

The economic operators also indicated that in at least one Member State, it was not allowed to denature alcohol with a method other than the nationally authorised ones. Producers could therefore not use another Member State's formulation for complete denaturation even when the alcohol was being moved under duty suspension.

> *"The problem for instance occurs when a bioethanol is produced in Slovakia and is sold to the Czech Republic. Based on the requirements of the demand and in accordance with the Regulation (EC) no. 3199/93, a bioethanol is mixed with a general denaturing mixture. Nevertheless, pursuant to the Slovak legislation such a product is not considered as a completely denatured alcohol and has to be classified as 2207 10 (and not as 2207 20), and all the same transportation procedures have to be followed as for an undenatured product (including e-AD in the EMCS).*
> *The same situation occurs if a mixture of bioethanol with any of the denaturing agents which are mentioned in the Regulation (EC) n. 3199/93 is made, but such a denaturing agent is not included in the Slovak legislation under complete denaturation. Nevertheless, some operators on the downstream market are allowed (based on their authorisation) to receive only completely denatured alcohol. Despite the fact that the product meets all the requirements for complete denaturation per Regulation (EC) no. 3199/93, it may not be classified as completely denatured, and so it has to be transported accordingly (and not only with a simplified document)."*
>
> *Survey respondent*

While the introduction of the Eurodenaturant as a denaturant recognised by all Member States has the potential to resolve at least some of these issues, the economic operators generally expressed dissatisfaction with this option. They were concerned that the current formulation (3 litres of IPA [isopropyl alcohol], 3 litres of MEK [methyl ethyl ketone] and 1 gram of denatonium benzoate) had **too great an effect on the characteristics of the final product** (it could, for instance, affect the intended performance of the final product). It was also argued that one of the ingredients (methyl ethyl ketone, MEK) was often difficult to obtain due to the limited number of producers in the EU, and that the large quantities needed would also require more storage space than any other denaturant. Several producers of denatured alcohol argued for a **reduction to a 1 litre / 1 litre / 1 gram combination**, which they suggested would still ensure the same level of protection against fraud while reducing storage costs, as well as reducing the cost of the denaturant itself. Others argued that they would always prefer their own or other Member States' national methods.

The differences in the **treatment of alcohol from third countries** compared to alcohol produced in the Member States have the potential to **create market distortions**. Particular problems might arise in those Member States whose national producers only have a limited choice of denaturants exempted under Article 27.1 (a), while alcohol imported from outside the EU can be denatured using any formulation and still be recognised as completely denatured. In this situation, denatured alcohol from outside the

EU could potentially be purchased more cheaply. However, none of the stakeholders consulted reported any specific concern with regard to this type of competition from outside the EU.

The exemptions under Article 27.1 (b) were also reported to create **uncertainty among economic operators** regarding whether a particular denaturing method would be accepted by another Member State, leading to financial risk for these operators. If it ultimately turns out that the alcohol cannot be exempted, excise duty becomes due.

While customs authorities might be willing to support national producers by giving them the necessary flexibility in the use of denaturants, they also have to consider the description in Regulation 162/2013[83]: "*the **proliferation of denaturing procedures adds complexity to the denaturing system, weakens the ability for effective administration of the system, and offers more opportunities for fraud***". Where the Member States stick to a limited list of denaturants, their customs laboratories can follow a simpler product-testing approach. Identifying the denaturant employed becomes particularly difficult when there are several possibilities. For economic operators, this can mean customs authorities holding up a product for several weeks for laboratory testing.

Depending on the Member State, a request for authorisation to use a specific denaturing method in order to qualify for exemption under Article 27.1 (b) can take up to four months, and is linked to administrative requirements and laboratory tests. In at least one Member State, the authorities do not recognise any other method than those already authorised in their national legislation. The decision by authorities regarding whether they will accept a particular denaturing method can **determine the production location** for some economic operators. In particular, large companies operating across the EU indicated that they would always consider moving their production to a different Member State if the authorities would not accept their desired denaturing method.

As a general comment, several producers noted that it was difficult to know which rules applied in other Member States regarding exemption under Article 27.1 (b). Such information, and the text of their national legislation, is rarely available in English and is often difficult to access. The differing interpretations of the Directive bring uncertainty for the economic operators.

### 4.4.2 Consequences for competition between economic operators

There are several circumstances where producers and users from one Member State are in a more advantageous situation than those of other Member States. These situations are described in this section, which also considers the price differences between the various denaturing methods.

The impacts on competition are linked to the differences in the recognition of denaturing methods for exemption under Article 27.1 (a). In the following situations, the economic operators from one group of Member States who interpret the provisions in one way have an **advantage over producers from another group of Member States** which understand the provisions differently:

- A user of denatured alcohol wanting to use the formulation for complete denaturation of the Member State in which the production of the final product takes place will, in a majority of Member States, be limited to buying the denatured alcohol from producers in their own country. In many Member States, denatured alcohol from other Member States will only be exempted if a method of complete denaturation recognised by the country of production has been used.
- Producers and users of completely denatured alcohol from Member States which accept any of the formulations listed in Regulation 162/2013 have an advantage over producers and users of completely denatured alcohol from Member States which limit the choice to their own method and the Eurodenaturant. In these

[83] Commission Implementing Regulation 162/2013 of 21 February 2013 amending the Annex to Regulation (EC) No 3199/93 on the mutual recognition of procedures for the complete denaturing of alcohol for the purpose of exemption from excise duty.

Member States, producers of completely denatured alcohol intending to send their products to another Member State also have this advantage.

- Considering the limitations and criticisms of the Eurodenaturant indicated above (see Section 4.4.1), producers and users of completely denatured alcohol from Member States that accept denaturants besides the Eurodenaturant for complete denaturation have an advantage over producers and users from Member States where only the Eurodenaturant is used. Member State authorities have understood this disadvantage for their producers, as shown by the French request to expand its formulations under Regulation 162/2013 to include the German and Hungarian method[84].
- Local producers of completely denatured alcohol have an advantage over the producers from other Member States when these can only send alcohol denatured with the national complete denaturing formulation under duty suspension. Not all local producers, especially the small ones, will be registered consignees. The number of potential customers is therefore limited.
- In seven Member States, alcohol that comes from third countries can receive an exemption as completely denatured alcohol if it has been treated using any of the methods specified by Regulation 162/2013, while their national producers can only use their own Member State's method and the Eurodenaturant.

In addition, a producer of denatured alcohol suggested that there were a number of Member States which nationally recognised other denaturing methods besides those listed in Regulation 162/2013 for complete denaturation. These Member States would grant the advantages of excise exemption and the simplified movement of completely denatured alcohol to products not denatured according to Regulation 162/2013. This has an impact on competition, whereby producers from other Member States cannot receive the same exemptions for that method when moving denatured alcohol to the country because these methods do not fall under mutual recognition. The producers must then send the denatured alcohol to the Member State concerned under duty suspension. However, the producers in that Member State might not be able to receive the product if they are not registered consignees. At the national level, the product is considered a completely denatured alcohol for which operators do not need to be registered consignees.

The advantages available to economic operators from one Member State compared to those from another can also be identified with regard to receiving an exemption for denatured alcohol under Article 27.1 (b). While most Member States have an open-ended list, meaning that it should be possible to have the methods of one Member State also be authorised by another, there is at least one Member State whose list for exemption under Article 27.1 (b) is not open-ended. Only the methods published in that list can be used by local and EU producers. This limits choices for the users of denatured alcohol in that Member State, as they will not be able to use denaturing methods fitting for the purpose of all types of products.

Multinational companies clearly have an advantage over the smaller producers and users of denatured alcohol. They have indicated that they would be prepared to **move their production to a different Member State** in order to obtain authorisation for a particular denaturant.

The economic operators underlined that **price was not the main factor in choosing a denaturant**. It is more important to find a denaturant that matches the quality requirements of the final product. This is particularly relevant with regard to Article 27.1 (b).

[84] Committee on Excise Duty (2014): Minutes of the meeting held on 12/06/2014. Alcohol taxation: vote – notification under Article 43 and 44 of Council Directive 2008/118/EC by France to use the national formulations of DE and HU (B) for completely denatured alcohol provided for in Annex of Commission Regulation 162/2013. CED Nr 848

Overall, the methods listed in Regulation 162/2013 for complete denaturation are fairly similar in price, with several economic operators estimating one of the Hungarian methods[85] to be the cheapest, costing about EUR 2 per hl. Many interviewees were concerned about the **high cost of using the current Eurodenaturant**. Due to the relatively large amount of its ingredients that is required, the price for denaturing one hl of alcohol with the Eurodenaturant was reported to be up to EUR 8, depending on the price fluctuations for its ingredients. In addition, according to several economic operators the costs of Eurodenaturant are increased further by the need for greater storage and transport capacity that results from the ingredients' substantial volume requirements.

The differences in cost are more significant for denaturing in accordance with Article 27.1(b). They were stated as ranging from EUR 0.8 and EUR 7 per hectolitre. This significant difference in cost is also linked to the varying complexity of the denaturants and the differing requirements in terms of quality. Because there is a significant degree of choice of denaturing methods for exemption under Article 27.1 (b) in the majority of Member States, price is not considered to be having an impact on fair competition between producers.

## 4.5 Is there scope for administrative burden and compliance cost reduction?

This section assesses the efficiency of the provisions for the exemption of denatured alcohol by identifying the scope for reduction of administrative burdens and compliance costs.

The ambiguity of the provisions concerning the exemption of denatured alcohol creates **administrative burdens and costs** both for the Member State authorities and for economic operators **that could be avoided**. Administrative burdens and costs for Member States and economic operators could be positively influenced by ensuring a common understanding of the provisions, and by increasing harmonisation. Economic operators specifically mentioned the use of Eurodenaturant as generating unnecessary costs.

However, the main concern of the economic operators regarding administrative burdens was linked to the specific requirements regarding supervision of production and movement in some Member States that cannot be directly linked to the provisions of the Directive, and which represent these Member States' national-level response to their estimations of the risk of fraud.

For the Member State authorities, the large number of potential denaturing methods makes **laboratory testing particularly difficult**. This could be facilitated by reducing the number of available denaturants, by proposing common formulations for product categories in which alcohol exempted under Article 27.1 (b) is used. Another solution suggested by Member States was to state in the documents accompanying a movement of denatured alcohol which denaturant had been used. This is especially relevant for movements of completely denatured alcohol.

Another suggestion for reducing the administrative tasks and costs for Member States was suggested by authorities in the context of the evaluation of Directive 2008/118/EC[86]. Here, six Member States suggested that all movements of denatured alcohol could take place under EMCS. They suggested that this could facilitate checking and reduce the uncertainties connected with the differences between completely denatured alcohol and alcohol to be exempted under Article 27.1 (b).

In first instance, a reduction of available denaturants would mean additional costs and burdens for economic operators. It would require producers to change current practices,

[85] Method (b) 1% by weight of methyl ethyl ketone (MEK), and 0.001% by weight of denatonium benzoate.
[86] Evaluation of current arrangements for the holding and moving of excise goods under excise duty suspension, Final report, prepared by Ramboll Management Consulting and Europe Economics.

identify new ways of buying the ingredients needed for these denaturants, and require users of denatured alcohol to test how best to replace their current methods. However, more harmonisation could lead to clearer rules and easier coordination with the authorities of other Member States.

The situation of economic operators could also be improved by **greater clarity with regard to the recognition of the denaturing methods** used by the different Member States. The burden of investigating whether a particular method can be used in another Member State could be alleviated. A broader recognition of the permissible methods for complete denaturation would allow the producers of denatured alcohol to send their products more easily to other Member States, as the recipients would not be required to be registered consignees in order to receive the completely denatured alcohol (which would then be recognised as such).

The **formulation of the Eurodenaturant** was mentioned by several economic operators as generating additional costs which could be avoided by reducing the amount of the ingredients needed (specifically, by reducing the amounts of MEK and IPA from three litres each to one litre). It was mentioned that this could reduce purchasing and storage costs.

In addition, there are examples of Member States' provisions in which the procedures for recognising a denaturing method or monitoring the production of denatured alcohol generate administrative burdens for producers. Nevertheless, the procedural differences are dependent on the individual Member States' assessments of the risk of fraud and their administrative practices.

## 4.6 EU added value

This section assesses to what extent setting rules for the exemption of denatured alcohol at EU level creates added value.

The source of the current complications is the **absence of clear rules at the EU level**. This leads to individual and contradictory approaches on the part of the Member States towards the exemption of denatured alcohol. In this sense, the added value from having Article 27 set rules at the EU level might be questioned. However, the current problems actually show that a **stronger common approach is needed**. Therefore, a clear added value from regulating the exemption of denatured alcohol at the EU level can be identified.

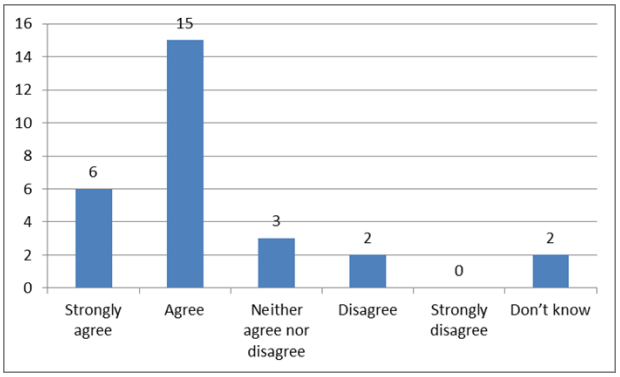
According to the Member States, there are clear advantages from establishing a common system for the recognition and management of exemptions of denatured alcohol from the scope of excise duty at the EU level. As Figure 35 shows, 21 of the Member States (strongly) agreed that setting rules on exemptions at the EU level was appropriate. The diverse nature of the advantages presented for acting at this level highlight the different expectations Member States have of the provisions regarding exemptions, and where they would like to see clearer rules.

Several Member States saw as the main advantages of defining common rules for the exemption of denatured alcohol a uniform application of provisions that allow for the standardised treatment of similar products for taxation purposes, better coordination between Member States, and legal certainty for all stakeholders. In the view of the Member States, such common rules would **reduce the number of available denaturing methods**, thereby facilitating laboratory analyses. Additionally, as five Member States mentioned, production and transport would be facilitated and administrative costs could be reduced. Seven Member States noted that having common rules could **avoid competitive disruptions** within the internal market. Also, the risk of fraud could be reduced through a similar robustness with respect to denaturing formulations and a common approach to monitoring and control.

The two Member States which disagreed that the establishment of a common system for exemptions of denatured alcohol at the EU level was appropriate did so not because they favoured a different approach, but because they observed that this *common system was not yet established*.

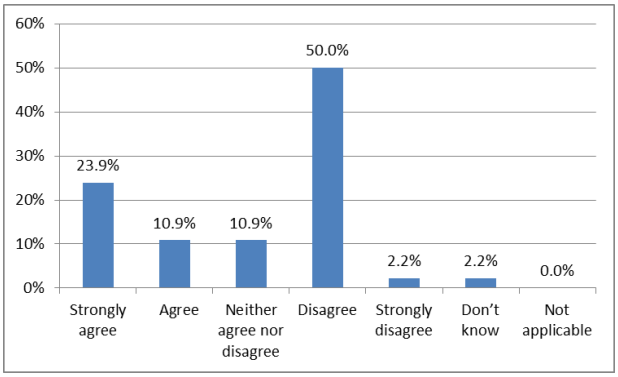
Overall, the Member States expressed their support for EU-level action regarding the exemption of denatured alcohol, and where changes were requested these were also expected to take place at the EU level.

**Figure 35:** ***The establishment of a common system for the recognition and management of exemptions of denatured alcohol from the scope of excise duty at the EU level is appropriate.***




*Source: Questionnaire to Member States*

**Figure 36:** ***Overall, I believe that the recognition and management of exemptions of denatured alcohol should be coordinated at the EU level.*** **(N=46)**




*Source: Survey to economic operators, August-November 2015*

In contrast to the Member States' opinions, respondents from the denatured alcohol industry and their trade associations tended to disagree that the recognition and management of exemptions of denatured alcohol should be coordinated at the EU level. More than half the respondents to this question (strongly) **disagreed that exemptions should be coordinated at the EU level**, as Figure 36 shows. However, a detailed analysis of these responses showed that only economic operators from the cosmetics, perfumes and personal hygiene products sector disagreed with the management and recognition of exemptions at the EU level. Since the users of denatured alcohol in this sector would have their products exempted in accordance with Article 27.1 (b), under which there is in fact no recognition and management of exemptions at the EU level, these responses should be considered as an approval of the status quo, together with a general disapproval of the work recently undertaken at the EU level.

Economic operators approving of an EU-level approach to exemptions for denatured alcohol highlighted the advantages in terms of simplified trade, improved market access and legal certainty. At the same time, they noted that there were still a lot of different possibilities for conflicting interpretations of the current rules.

## 4.7 Potential actions for addressing identified issues

There are different approaches that could be taken when responding to the issues experienced by the Member States and economic operators regarding the exemption of denatured alcohol. These are presented in Table 13 below, and are split between the provisions relating to both articles, those concerning Article 27.1 (a) and those relating to 27.1 (b). These solutions were identified in the context of the case study on denatured alcohol (see Appendix 8 – *In-depth case study on the management of exemptions for denatured alcohol*). As there are advantages and disadvantages associated with all these solutions, only a selection of these potential solutions has been selected in order to develop the final recommendations set out in Chapter 10.

**Table 13: Potential solutions to the issues encountered with the exemption of denatured alcohol**

| | |
|---|---|
| **Responses to issues in connection with both articles** | |
| Creating a clear **distinction between Articles** 27.1 (a) & (b) | Currently, there is no clear distinction between the scope of Article 27.1 (a) and (b). Depending on the circumstances, in one situation a product can be considered a completely denatured alcohol, while in another Member State, or when it comes from another Member State, the same product can only be exempted under Article 27.1 (b). Along with this difference come different holding and moving requirements.<br>The findings show that it will be difficult to link the exemption under Article 27.1 (b) to the intended use of the product, as the potential uses for denatured alcohol are endless. In this context, it should also be made clear under what circumstances the simplified provisions for holding and moving excise duty goods under Directive 2008/118/EC can be applied |
| Ensure a consistent approach towards **denatured alcohol coming from outside the EU** | The requirements applying to completely denatured alcohol coming from third countries into the EU differ across the Member States. Several authorities indicated that operators from third countries can use any of the denaturing methods listed in Implementing Regulation 162/2013 for complete denaturation, whereas national producers can only use the method listed by their country.<br><br>Such a treatment can create unfair competition for producers from the EU compared to those from outside the EU. Producers from third countries could potentially be advantaged over EU producers.<br><br>In this regard, the Committee on Excise Duty noted in 2014 that "in case of importation and clearance for free circulation it is the Member State of importation who has to monitor that the denaturing has been properly done in accordance with the rules of the Member State of importation. All other Member States are dependent on the decisions of the Member State of importation".<br><br>Ensuring that the Member States follow this understanding and request the use of the denaturing method of the country where the alcohol will be released into free circulation would ensure that denatured alcohol from outside the EU was treated the same way in all Member States. Ideally, a system should be found that creates a level playing field between different producers, and which establishes the same requirements for the importing of denatured alcohol into all Member States.<br><br>However, a level playing field could only be achieved if the principle of mutual recognition was understood to require all Member States to recognise all denaturing formulations noted under Regulation 162/2013, including for national production and for alcohol coming from other EU Member States.<br><br>Further research should be undertaken in order to better understand the needs of economic operators and the actual impact on competition of this inconsistent approach. |
| **Responses to issues encountered in connection with Article 27.1 (a)** | |
| Recognise **only the Eurodenaturant** for complete denaturation | A solution to the variability of the acceptance criteria for other Member States' methods for undertaking complete denaturation would be to limit the exemptions under 27.1 (a) to the use of Eurodenaturant. The same conditions would apply to all economic operators across the EU, and for complete denaturation a method would be used which is considered to ensure high protection against fraudulent activities intended to render denatured alcohol drinkable again.<br><br>While the sole use of Eurodenaturant might have been envisaged when it was introduced, Regulation 162/2013 does not clearly express this intention. The preamble of the Regulation notes that some Member States had "*expressed the* |

| | |
|---|---|
| | *wish to maintain them* [their national methods] *for a transitional period or for a non-specified period of time due to specific technical requirements"*[87], but does not propose a clear deadline by when no formulations besides Eurodenaturant would be recognised. The Member States[88] and economic operators (in the context of the survey and the interviews) have both clearly indicated that it would be difficult for them to agree on using Eurodenaturant alone. Since there are no clear instructions in the Regulation about how to restrict the number of methods for complete denaturation, it would be difficult to implement this solution.<br><br>In addition, the findings of the study do not suggest that there should be only one denaturing method, either to prevent fraud or to ensure fair competition between economic operators. Competition issues could also be solved by ensuring a common interpretation of mutual recognition under Article 27.1 (a). |
| **Change the Eurodenaturant formulation** to a 1-1-1 ratio | There are clear concerns among economic operators about the current Eurodenaturant formulation. Several operators noted that for quality and cost reasons, they could only work with a formulation containing less IPA and MEK (specifically, one comprising 1 litre IPA / 1 litre MEK / 1 gram denatonium benzoate). Such a formulation would reduce the cost of purchasing the ingredients and storing the denaturant. The formulation would also influence the final product less, as it would represent a smaller proportion of the product. The Member States and the economic operators both suggested that the changed formulation would still offer the same degree of protection against fraud. However, even with this formulation it is possible that not all the economic operators would be satisfied, as several of them stated they would continue to prefer their current national method. |
| Ensure a common understanding of **mutual recognition** | It is unclear from the Directive and the associated legislation whether the intention when the mutual recognition of denaturing methods was introduced was to request the Member States to accept any other denaturing methods, or to accept a denaturing method when it is being used by a producer from the Member State which notified the specific method. However, considering the opinion of the Commission in the Committee of Excise Duty on allowing France to use the denaturing methods of Germany or Hungary[89], it seems as if the Commission prefers to follow the second interpretation. While the recognition of any denaturing method from any Member State would eliminate most issues of unfair competition between the operators of different Member States, the other scenario would also represent at least a partial solution if it was consistently applied across the Member States. But in the second scenario, those economic operators in Member States where the Eurodenaturant was not the only denaturant recognised for complete denaturation would have an advantage over operators from other Member States. However, this advantage could be reduced by making the Eurodenaturant formulation more practicable, as explained above, or by allowing Member States to add a formulation to Regulation 162/2013.<br><br>The suggested changes could be implemented either through a change in the Directive or by stricter enforcement from the Commission of their understanding of mutual recognition. As the latter could be disproportionately confrontational, giving clearer guidance by actually changing the wording of the Directive might be more appropriate.<br><br>In the context of the implementation of one of these changes, it would also be necessary to correspondingly amend the understanding regarding alcohol imported from third countries. |
| **Responses to issues encountered in connection with Article 27.1 (b)** | |

[87] Implementing Regulation 162/2013 of 21 February 2013 amending the Annex to Regulation (EC) No 3199/93 on the mutual recognition of procedures for the complete denaturing of alcohol for the purposes of exemption from excise duty; Preamble – Indent (6)
[88] See, for example, Committee on Excise Duty (2014): Interpretation and Application of Commission Regulation (EU) No 162/2013 of February 2013 amending the Annex to Regulation (EC) No 3199/93 (CED 846)
[89] Committee on Excise Duty (2014): Alcohol Taxation: Vote – Notification under Article 43 and 44 of Council Directive 2008/118/EC by France to use the national formulations of DE and HU (B) for Completely Denatured Alcohol (CDA) provided for in Annex of Commission Regulation (EU) 162/2013. Procedure under Article 27 (3) and (4) of Council Directive 92/83/EEC

| | |
|---|---|
| Defining "**not intended for human consumption**" | Changing the wording of Article 27.1 (b) could clarify the distinctions regarding the use of completely denatured alcohol, avoiding the current inconsistent use of the two categories and rendering unambiguous the conditions for granting the exemption.<br><br>The agreed understanding that the term "*used for the manufacture of any product not intended for human consumption*" refers to a product in its final form, which was laid down by the Indirect Tax Expert Group[90], could be inserted into the actual Directive. It could even state how movements in bulk should be handled so as to avoid any future disputes.<br><br>An amendment of Article 27.1 (b) could also restate the purpose of this particular exemption in order to underline the distinction between it and completely denatured alcohol. In this context, it would also be possible to list particular uses of denatured alcohol that would qualify for this exemption, specifically defining the products concerned.<br><br>This solution could reduce some of the current uncertainties, simultaneously avoiding the limiting of denaturing methods and the restricting of producers' and users' flexibility. It would also require no research or investment in finding denaturing methods that suited all the producers in a particular sector. To limit potential fraud, it should be emphasised that until the point at which it is considered to become exempt under a revised Article 27.1 (b), the alcohol should be stored, held and denatured in tax warehouses (as is currently the case), and that wherever a Member State considers that a denaturing method is linked to an abuse, the authorities can request another Member State to withdraw this method (see Article 27.5 of the Directive). |
| Exempting denatured alcohol used in the **production chain** | It should be clarified whether the term "used for the manufacture" includes the use of denatured alcohol in the production chain, such as for cleaning purposes. Considering the strong support both from economic operators and the Member States, the exemption of denatured alcohol when used in the production chain for cleaning purposes should be further looked into. Such an exemption could represent important economic savings for some users of denatured alcohol. However, before such a provision is introduced, the risk of fraud in this context should be assessed in cooperation with the Member States.<br><br>A Commission recommendation laying down clear requirements for the exemption and giving Member States the choice to apply the exemption or not (depending on nationally assessed risks) should be the approach here. |

[90] European Commission, Indirect Tax Expert Group (2014) Opinion 1/2014 – Interpretation of the term "used for the manufacture of any product not intended for human consumption" in Article 27 (1) (b) of Council Directive 92/83/EEC; TAXUD(2014)01009

# 5. Excise duty gap relating to fraud involving alcohol and alcoholic beverages

In this section, we assess the extent of the fraudulent use of denatured alcohol and the corresponding effect on tax revenues. By definition, fraudulent activity is illicit in nature, and is therefore inherently difficult to measure accurately. We therefore draw upon a wide range of sources in order to conduct our analysis. Specifically, we have adopted the following approach, which is reflected in the structure of this section:

- We first present the rationale for the analysis. In particular, we draw on the survey responses to better understand whether the abuse of exemptions for denatured alcohol is a significant problem.
- Second, given the difficulties inherent in attempting to quantify the extent of the fraudulent use of denatured alcohol in order to circumvent alcohol excise duties, we seek to estimate the likely volume of alcohol fraud overall in order to establish an upper bound to the possible magnitude of fraud relating to exemptions for denatured alcohol.
- Third, building on the analysis of overall fraud, we seek to generate estimates of the tax gap resulting from the fraudulent use of denatured alcohol.
- Finally, having established estimates of the fraudulent use of denatured alcohol, we consider whether particular sources of this fraud are more prevalent than others.

## 5.1 Summary of findings

**It is difficult to draw definitive conclusions on the levels of fraudulent use of denatured alcohol.** Given the difficulties inherent in quantifying the extent of fraudulent use of denatured alcohol in order to circumvent alcohol excise duties, we have first sought to understand the likely volume of alcohol fraud overall (i.e. including but not limited to fraudulent use of denature alcohol) in order to provide an upper bound (and sense check) to the possible magnitude of fraud related to exemptions for denatured alcohol.

**While the data are varied in quality, the evidence suggests that volumes of overall alcohol fraud and the corresponding tax gaps are significant in six Member States.** Indeed, it is difficult even to draw definitive conclusions on the levels of overall alcohol fraud. Volumes of overall alcohol fraud and the corresponding tax gaps were found to be important in the following Member States:

- Bulgaria (spirits).
- Spain (spirits, beer and intermediate products).
- Malta (intermediate products, other fermented beverages and wine).
- Poland (spirits and intermediate products).
- Slovakia (spirits).
- UK (spirits and beer).

In absolute volume and value terms, the largest problems appear to be in the UK and Poland. However, it is important to recognise that there is a large degree of uncertainty in these estimates, and therefore, they should be treated with caution.

**With regard to fraud with denatured alcohol, the countries affected overlap with but are not identical to those with the more significant tax gaps related to overall fraud in the alcohol sector**. The estimates of the levels of overall fraud provide a useful frame of reference for the levels of abuse of exemptions for denatured alcohol. In absolute terms, Poland and Spain have the most significant losses due to fraud with denatured alcohol.

**Our estimates indicate that the tax losses stemming from this element of the Directive tend not to be large in the context of the size of the tax gap associated**

**with alcohol fraud overall**; however, the problem is non-trivial. The table below summarises the largest estimated impacts:

**Table 14: Estimation of duty loss due to the abuse of exemptions of denatured alcohol**

| MS | Sprits | |
|---|---|---|
| | Volume (hl) | Duty (€m) |
| **DE** | 0 - 31.6 | 0 - 4.12 |
| **EE** | 12.5 - 36.6 | 2.36 - 6.92 |
| **ES** | 663 - 1,160 | 60.5 - 106 |
| **FR** | 0 - 25.9 | 0 - 4.48 |
| **PL** | 554 - 1080 | 75.6 - 147 |
| **SK** | 13.3 - 59.4 | 1.44 - 6.41 |
| **UK** | 0 - 44.2 | 0 - 15.7 |

*Source: Europe Economics analysis based on data from DG TAXUD and survey results.*

**The estimations of fraud with denatured alcohol are linked to an important degree of uncertainty**. As can be seen above, there is fraudulent use of denatured alcohol in order to circumvent excise duties. However, there is a large degree of uncertainty in these estimates – the problem could be much larger, or it could be smaller. In the latter case, given the relatively small magnitude of abuse of exemptions for denatured alcohol (in duty terms), lower levels of this type of fraud in reality (compared to what has been reported by Member States) could reduce the tax gap to the point where it would become disproportionate to try and prevent this type of fraud if the costs of doing so outweighed the gain. However, this cannot be concluded based on the evidence available.

## 5.2 Rationale for the analysis

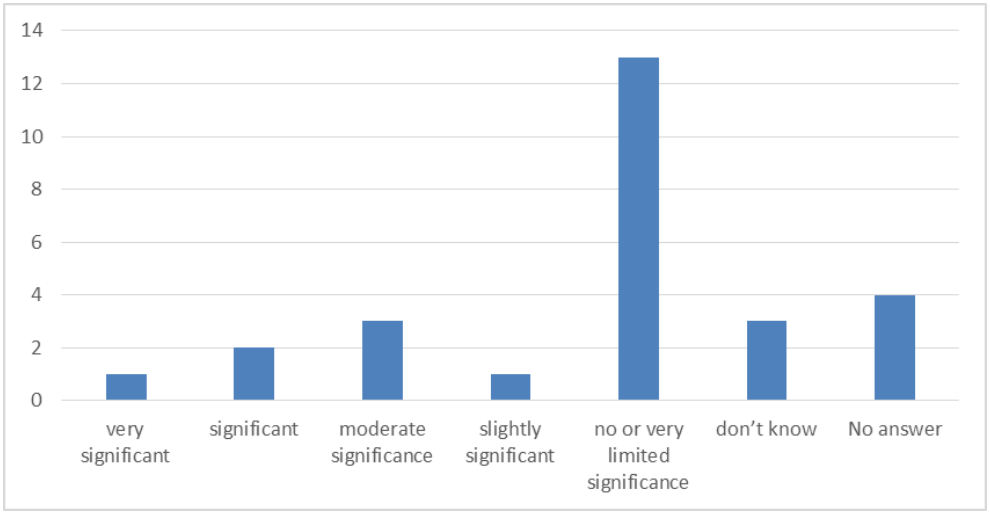
This section presents a first overview of fraud estimates by the Member States. It provides a rationale for the further analysis conducted.

The results of the consultation of the Member States demonstrated that the majority of Member States did not consider the abuse of exemptions for denatured alcohol to be a material concern. However, six out of the 22 Member States responding did highlight this method of fraud as being at least somewhat significant. This method was seen to be associated with a relatively small duty loss (generally less than 5%, where a tax gap was identified). Nonetheless, it is clear both from the survey responses and from interviews conducted with experts in this area that **this type of fraud does occur and can be highly significant for some of the Member States affected**. Therefore the extent of the fraudulent use of denatured alcohol and the likely tax implications of this type of fraud has been further investigated.

### 5.2.1 Significance of the abuse of exemptions for denatured alcohol

In the stakeholder consultation, the Member States were asked about the significance of the various alcohol fraud methods being used in their respective countries. It appears that the abuse of exemptions for denatured alcohol is not a broadly shared concern for most Member States. In total, six Member States considered it to be of some significance as a method of fraud. The degree of individual significance varies — Cyprus considered it to be very significant, the Czech Republic and Poland considered it to be significant, and Estonia, Spain and Latvia considered it to be moderately significant. **Other methods of fraud**, such as smuggling from other Member States and illegal production, **were generally perceived to be more significant** than the abuse of exemptions for denatured alcohol.

**Figure 37: Views of the Member States on the significance of the abuse of exemptions for denatured alcohol**




*Source: Survey to Member States*

### 5.2.2 Extent of duty loss

For each category of duty loss, the Member States were asked to estimate the percentage of the total loss that was attributable to fraudulent activity connected with the abuse of exemptions for denatured alcohol. Most Member States either indicated "do not know" or simply did not provide an answer. This is unsurprising, given the inherent difficulty in estimating levels of fraud. For those that did provide an estimate, the majority indicated that the duty loss due to the abuse of denatured alcohol exemptions is less than 5%.

However, as can be seen in Table 15, there is a wide distribution of impacts, with very high estimated impacts in a small group of Member States. The **most highly affected product category** — as is to be expected in the case of denatured alcohol — is the **duty on spirits**. Spain indicated that the abuse of denatured alcohol exemptions accounts for 61-80%of the total losses due to fraudulent activity connected with the duty on spirits, and Estonia and Poland indicated a loss range of 41-60%. [91]

**Table 15: For each category of alcohol, estimated duty losses arising from fraud connected with abuse of the exemptions for denatured alcohol, expressed as a percentage of the total duty losses attributable to fraudulent activities (no. of Member States)**

| | 61-80% | 41-60% | 21-40% | 6 - 20% | <5% | Do not know | No answer |
|---|---|---|---|---|---|---|---|
| Loss of spirits duty | 1 | 2 | | 1 | 7 | 11 | 5 |
| Loss of intermediate products duty | | | 1 | | 10 | 10 | 6 |
| Loss of other fermented beverages duty | | | | | 10 | 11 | 6 |
| Loss of beer duty | | | | 2 | 8 | 11 | 6 |
| Loss of wine duty | | | | 1 | 8 | 11 | 7 |

*Source: Survey to Member States*
*Note:* It should be noted that these estimates do **not** suggest that 41-80% of denatured alcohol used in these Member States is fraudulent or that the level of fraud in these Member States is 41-80%. With this important clarification in mind, and bearing in mind the response from the Estonian authority, we do not consider it inherently infeasible that these estimates are correct, though we note that all of the estimates are based on the Member States' estimations and have not been independently verified as part of the study.

[91] The authorities of these three Member States were contacted to confirm their estimations. Only a response from the Estonian Tax and Customs Board was received. They confirmed the estimate, noting that it was based on alcohol seizure data.

### 5.2.3 Diversion from intended uses

Another way of looking at this problem is to consider the extent to which denatured alcohol is being diverted from its intended use in other supply chains. The Member States were asked about the prevalence of this problem in different industries. Again, the majority of Member States (i.e. 15-19) indicated either "do not know" or did not answer. Among those that did answer, most respondents reported that less than 4% of denatured alcohol is being diverted from its intended use across all supply chains.

However, **there are indications of more serious problems with the diversion of denatured alcohol in a few Member States**. The Spanish and Polish authorities estimated that more than 20% of the denatured alcohol intended for the categories "screen wash, antifreeze and de-icers" and "printing inks, paints, and other solvents" is being diverted from those supply chains in a bid to produce untaxed potable alcohol. The proportion of diverted denatured alcohol intended for "screen wash, antifreeze and de-icers" was 8-12% for Estonia and 4-8% for the Czech Republic. The Polish authority also indicated that the percentage of diversion from the "cosmetics, perfumes and personal hygiene products" category, as well as biofuels, is around 8-12%, with another 4-8% being diverted from the category "printing inks, paints and other solvents".

**Table 16: Percentage of diversion of denatured alcohol from intended uses (no. of Member States)**

| | >20 % | 16-20 % | 12-16% | 8-12 % | 4 - 8% | <4% | Do not know | No answer |
|---|---|---|---|---|---|---|---|---|
| Cosmetics, perfumes and personal hygiene | | | | 1 | | 7 | 12 | 7 |
| Screen wash, antifreeze and de-icers | 2 | | | 1 | 1 | 8 | 9 | 6 |
| Biofuels | | | | 1 | | 7 | 12 | 7 |
| Printing inks, paints, and other solvents | 1 | | | | 1 | 7 | 12 | 6 |
| Other industries | | | | | | 7 | 10 | 9 |

*Source: Survey to Member States*
*Note:* These estimates are based on Member States' views and have not been independently verified as part of the study, nor has it been possible to corroborate these estimates with data from other sources. Therefore, the results presented in the table should be treated with caution; nonetheless, they provide an indication that certain Member States consider the diversion of denatured alcohol from certain industrial uses in a bid to avoid tax to be a non-trivial issue.

## 5.3 Volume of all types of alcohol fraud

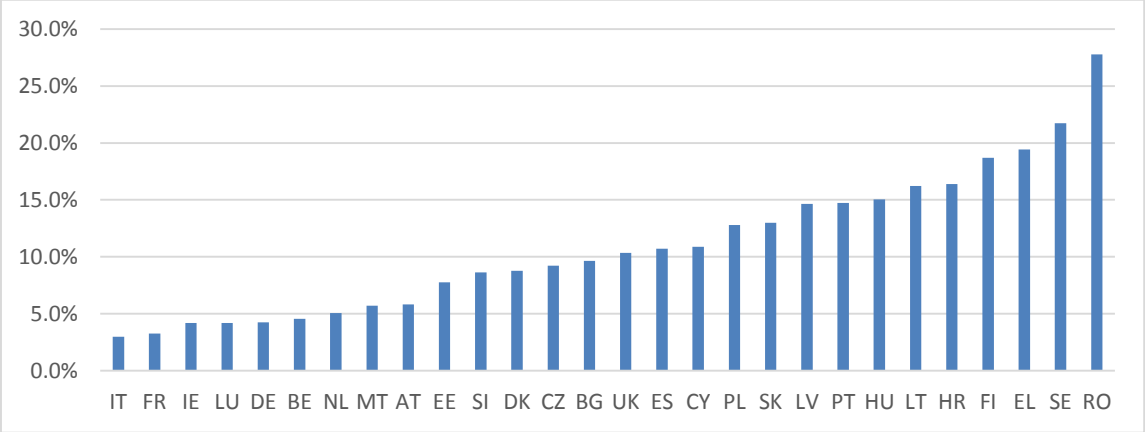
Given the difficulties inherent in attempting to quantify the extent or value of fraudulent use of denatured alcohol in order to circumvent alcohol excise duties, a sensible first step is to understand the likely volume of alcohol fraud overall in order to provide an upper bound to (and sense check) the possible magnitude of fraud related to exemptions for denatured alcohol.

In this section, we seek to establish the extent of alcohol fraud across Europe. Given the difficulty and uncertainty in measuring illicit activity such as alcohol fraud, it is necessary to draw on a wide range of sources in order to consider the likely volume of fraud taking place. This analysis covers all types of such fraudulent activity. We examine the fraudulent use of denatured alcohol in Section 5.4.

### 5.3.1 Unrecorded alcohol consumption

One potential indicator of the level of alcohol fraud — albeit a crude one — is the degree of alcohol consumption that goes unrecorded (explained below). The World Health Organisation (WHO) has in the past produced a global status report on alcohol and health, based on a mix of empirical investigation and expert opinion, which has included estimates of unrecorded alcohol consumption. We present the percentage of unrecorded alcohol consumption per capita (APC) below.

**Figure 38: Unrecorded alcohol consumption as a proportion of total alcohol consumption**




*Source: WHO Global status report on alcohol and health (2014)*

Romania has the highest unrecorded proportion of the total consumption of alcohol per capita, at around 27%. This is followed by Sweden, Greece and Finland. Italy has the lowest figure, at around 3%.

When considering the chart above, it is important to note that the data includes unrecorded consumption besides that due to fraudulent alcohol, such as home-brewed alcohol and alcohol imported from third countries and released into free circulation. The WHO data relates to litres of alcohol, and is not broken down by alcohol type: this is important, because the fraudulent use of denatured alcohol will typically relate to illicit spirit consumption. Therefore, to the extent that the unrecorded consumption data (based on the WHO statistics) in a particular Member State reflects the consumption of alcoholic products other than spirits, a misleading impression may be created as to the extent of fraud in that Member State. Nonetheless, the **data presented above still provide a useful insight into the possible extent of fraud**.

An older report (2002) published by the European Commission also estimated the amount of unrecorded alcohol consumption per inhabitant[92]. Some estimates are similar to those from the WHO report. For instance, both reports estimated the unrecorded APC in Belgium as 0.5 litres. However, other estimates diverge significantly. In Germany, for example, the WHO estimated unrecorded consumption at 0.5 litres per capita, while the European Comparative Alcohol Study (ECAS) estimated it to be 2 litres. This may be due to measurement errors in one or both of these studies, or the scale of unrecorded consumption may have changed over time — or both. Given the age of the European Commission's report compared with the WHO study, we consider it more appropriate to draw on the more recent, more comprehensive WHO data set in order to estimate the likely levels of unrecorded consumption across Europe, and hence the possible magnitude of alcohol fraud in the EU.[93]

### 5.3.2 Tax gap estimates from the survey of Member States

Another approach for determining the extent of alcohol fraud in the EU is to look at the Member States' own estimates of tax gaps attributable to fraud. The stakeholder consultation exercise asked the Member States to provide their best estimates for the tax gaps as a percentage of the total potential tax liabilities in the latest year. Six Member States indicated that they did not know, and seven Member States provide no answers for any of the alcohol categories. However, for the remaining Member States that responded to this question, estimates were provided for at least one category of alcohol. As can be seen, the majority of these Member States estimated the number to be less

[92] Leifman (2001) "Estimations of unrecorded alcohol consumption levels and trends in 14 European countries".
[93] Similar logic applies to the other sources we considered, such as Leifman (2001) "Estimations of unrecorded alcohol consumption levels and trends in 14 European countries".

than 4%. Spain, Malta and Poland stand out, with estimated tax gaps over 4% across multiple alcohol categories[94].

**Table 17: Member States' estimates of their respective tax gaps (%)**

| MS | Spirits duty | "Intermediate products" duty | "Other fermented beverages" duty | Beer duty | Wine duty |
|---|---|---|---|---|---|
| **BG** | 12 - 16% | <4% | <4% | <4% | <4% |
| **CZ** | <4% | <4% | <4% | <4% | <4% |
| **DE** | <4% | <4% | <4% | <4% | No answer |
| **DK** | <4% | <4% | <4% | <4% | <4% |
| **EE** | 4 - 8% | <4% | <4% | <4% | 4 - 8% |
| **ES** | 12 - 16% | 16 - 20% | Do not know | 12 - 16% | Do not know |
| **HR** | 16 - 20% | Do not know | Do not know | <4% | <4% |
| **HU** | <4% | <4% | <4% | <4% | <4% |
| **IT** | <4% | <4% | <4% | <4% | <4% |
| **LU** | <4% | <4% | <4% | <4% | <4% |
| **LV** | 12 - 16% | <4% | <4% | <4% | <4% |
| **MT** | 4 - 8% | 8 - 12% | 12 - 16% | 4 - 8% | 16 - 20% |
| **PL** | 12 - 16% | 12 - 16% | 4 - 8% | 4 - 8% | 4 - 8% |
| **SI** | <4% | <4% | <4% | <4% | <4% |
| **SK** | 12 - 16% | Do not know | Do not know | <4% | <4% |
| **UK** | 4 - 8% | <4% | <4% | 12 - 16% | 4 - 8% |

*Source: Survey to Member States.*

Combining these estimates with DG TAXUD tax receipts, we have estimated ranges for the tax gap in these Member States, expressed in Euros. Using these Euro-based estimates and the primary rate of excise duty for each of these products, we were able to infer the **possible volume of untaxed alcohol** in these Member States. The results are shown in the table below:

**Table 18: Estimates of the tax gap (volume in hectolitres and duty in millions of Euros)**

| MS | Spirits | | Intermediate products | | Wine | | Beer | |
|---|---|---|---|---|---|---|---|---|
| | Volume | Duty | Volume | Duty | Volume | Duty | Volume | Duty |
| **BG**[1] | 204 - 272 | 11.5 - 15.3 | 0 - 2 | 0 - 0.01 | N/A | 0 | 0 - 19,800 | 0 - 1.52 |
| **CZ**[1] | 0 - 95 | 0 - 9.81 | 0 - 5 | 0 - 0.04 | 0 - 46 | 0 - 0.39 | 0 - 57,400 | 0 - 6.68 |
| **DE**[1] | 0 - 632 | 0 - 82.4 | 0 - 39 | 0 - 0.59 | N/A | N/A | 0 - 345,000 | 0 - 27.2 |
| **DK**[2] | 0 - 31 | 0 - 6.19 | 0 - 8 | 0 - 0.16 | 0 - 571 | 0 - 8.91 | 0 - 6,650 | 0 - 5.01 |
| **EE**[2] | 30 - 61 | 5.76 - 11.5 | 0 - 2 | 0 - 0.05 | 71 - 143 | 0.69 - 1.39 | 0 - 2,380 | 0 - 1.72 |
| **ES**[1] | 1,090 – 1,450 | 99.2 – 132 | 512 - 640 | 3.13 - 3.91 | 0 | 0 | 52,000 - 69,300 | 38.9 - 51.8 |
| **HR**[2] | 88 | 6.07 | N/A | N/A | 0 | 0 | 0 - 5,970 | 0 - 3.12 |
| **HU**[2] | 0 - 65 | 0 - 7 | 0 - 6 | 0 - 0.05 | 0 - 72 | 0 - 0.38 | 0 - 11,200 | 0 - 5.86 |
| **IT**[1] | 0 - 232 | 0 - 24.0 | N/A | N/A | 0 | 0 | 0 - 38,400 | 0 - 23.0 |
| **LU**[1] | 0 - 14 | 0 - 1.43 | N/A | 0 - 0.04 | 0 | 0 | 0 - 1,890 | 0 - 0.15 |

[94] However, the reference year in question was not consistently identified.

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **LV**[2] | 95 - 127 | 12.9 - 17.2 | 0 - 11 | 0 - 0.12 | 0 - 76 | 0 - 0.53 | 0 – 2,660 | 0 - 1.01 |
| **MT**[1] | 3 - 7 | 0.46 - 0.91 | N/A | N/A | 0 | 0 | 751 - 1,450 | 0.13 - 0.25 |
| **SI**[2] | 0 - 6 | 0 - 0.85 | 0 - 1 | 0 - 0.01 | 0 | 0 | 0 - 2,670 | 0 - 3.23 |
| **PL** | 1,350 – 1,800 | 184 - 246 | N/A | N/A | 913 – 1,830 | 3.45 - 6.9 | 178,000 – 356,000 | 33.1 - 66.3 |
| **SK**[2] | 223 - 297 | 24.0 - 32.1 | N/A | N/A | 0 - 19,500 | 0 – 155 | 0 - 6,190 | 0 - 2.22 |
| **UK**[2] | 442 - 884 | 157 – 314 | 0 - 355 | 0 - 16.6 | 4,340 - 8,680 | 195 - 391 | 219,000 - 292,000 | 517 - 689 |

*Source: Europe Economics analysis based on TAXUD data and survey results.*
*Note 1: Taxation set on the basis of degrees Plato of finished product.*
*Note 2: Taxation set on the basis of degree of alcohol of finished product.*
*Note 3: Numbers presented to three significant figures*

When considering the volumes of fraudulent alcohol presented in the table above, it is important to note the following:

- The results are based on the percentage ranges provided by the Member States in their survey responses. Specifically, we have taken the upper and lower bounds of each range estimate. The majority of responses (where an estimate was provided) indicated a tax gap of less than 4%. In these cases, it is likely that the upper bound of 4% is not a realistic estimate of the tax gap, and therefore (by inference), the level of fraud, as the respondents may have selected this option to in order represent very small tax gaps.
- The respective categories of alcohol used in the DG TAXUD's tax receipts and the survey are slightly different. In this exercise, we have used the responses for "wine" in connection with the tax receipts for "still wine" plus "sparkling wine". For the same reason, we have not included an analysis of "other fermented beverages", as this category is not included in the published tax receipts. In addition, for the tax rates for wine (sparkling and still), we have used the rates for still wine unless the tax receipts from sparkling wine are higher.
- The excise duty rates we have used to infer the volumes of fraud are based on the primary excise duty rate, which does not account for the variety of rates that apply in practice in the various Member States. Where there are multiple rates for a single category of alcohol, we have picked the rate applicable to the lowest alcohol content (which is usually the lowest rate). This is for reasons of consistency, and in order to err on the side of caution; however, the volume estimates for fraud presented above may consequently represent an overestimate.
- The estimates presented above take no account of the methodological robustness of the Member States' estimations of the tax gap in the survey. For example, when undertaking this type of calculation it is important to factor in the price elasticity of demand. Fraudulent alcohol is cheaper than legitimate alcohol subject to tax. If brought into the tax system, it would become more expensive, and therefore result in lower demand; the degree of this effect would depend on the price elasticity of demand. It is not possible to ascertain the underlying methodologies that were used by the Member States when completing the survey.

Nonetheless, despite these caveats these estimates provide a useful guide to the potential level of fraud that may exist in the EU Member States.

### 5.3.3 Seizures

To supplement our understanding of the composition of the trade in illicit alcohol, it is sensible to also look at the data for seizures of illicit alcohol. This provides information about actual instances of alcohol fraud, rather than estimates extrapolated from other information or based on the opinions of experts. Clearly, this will only give a limited picture of the extent of fraud; nonetheless, it is useful to regard this source as an indicator of the potential detection rates, and as a cross-check for the overall estimates of fraud.

The stakeholder consultation asked the Member States for their **best estimates** of the volumes of wine, spirits and beer and other alcoholic beverage (i.e. covering fermented beverages other than wine and beer, and intermediate products) they had seized in 2014. The results for each of these categories (as well as "All" where Member States reported a total level of seizures, rather than totals for each category of product) are summarised below. Among the countries that provided estimates, the **UK has the highest seizure volume**. In total, the UK seized close to seven million litres of alcohol, including more than five million litres of beer. Germany and Sweden also seized large amounts of alcohol in absolute terms.

**Table 19: Seizures (in litres unless specified otherwise)**

| | Wine | Spirits | Beer | Other | All |
|---|---|---|---|---|---|
| **BG** | 23,783 | 160,300 | 50,040 | - | |
| **CZ** | | 194,194 | | | |
| **DE** | | 104,000 | 367,000 | 1,000 | |
| **DK** | 4,147 | 2,050 | 84,260 | | |
| **EE** | | 6,845 | 314 | | |
| **FI** | | | | | 7,382 |
| **HR** | 43,822 | 17,791 | | | |
| **HU** | 44,360 | 28,630 | 19,030 | 40,180 | |
| **IE** | 23,471 | 5,959 | 10,808 | | |
| **LT** | | | | | 148,638 |
| **LU** | | 1600 bottles | | | |
| **LV** | | 15,600 | | | |
| **MT** | 5 cases - 359 bottles | 9 cases - 1900 bottles | | | |
| **PL** | 168,825 | | | | |
| **PT** | 324 | 2,217 | 17,104 | 70,909 | |
| **SE** | 51,462 | 68,016 | 428,403 | | |
| **SI** | 2,223 | 263 | 11,260 | | |
| **SK** | 1 | | | | |
| **UK** | 1,188,398 | 593,496 | 5,119,549 | | |

*Source: Survey to Member States*

The World Customs Organisation (WCO) collects and reports data on illicit alcohol.[95] According to the WCO, in 2014 over 1,000 seizures of beverages (beer, wine and other alcoholic products) were registered. These seizures represent nearly five million litres in total for different categories of alcohol. As can be seen in the table below, illicit whisky is the most commonly seized drink, followed by beer made from malt. However, in terms of the quantity (in litres), "undenatured ethyl alcohol of an alcohol strength by volume of 80% or higher" ranked highest in 2014 (a significant rise from 2013, when beer came top). We consider these data further in the following section on the fraudulent use of denatured alcohol. When considering the table below, it is important to note that the WCO data are not broken down by country and also include non-EU countries, and should therefore be treated with considerable caution.

**Table 20: Seizures of alcohol and alcoholic beverages**

| | 2013 | | 2014 | |
|---|---|---|---|---|
| | Number of seizures | Quantity (litres) | Number of seizures | Quantity (litres) |
| **Beer made from malt** | 205 | 710,454 | 250 | 89,085 |
| **Gin and geneva** | 2 | 192 | - | - |

[95] World Customs Organisation (2014) "Illicit Trade Report".

| | | | | |
|---|---|---|---|---|
| **Liqueur** | 18 | 25,101 | 20 | 481 |
| **Other fermented beverages (i.e. cider, perry, mead)** | 5 | 58,558 | 5 | 4,61 |
| **Other** | 3 | 21 | 11 | 3,045 |
| **Rum and tafia** | 13 | 7,553 | 7 | 974 |
| **Spirits obtained by distilling grape wine e.g. cognac, grappa, brandy etc.** | 14 | 4,008 | 18 | 1,834 |
| **Undenatured ethyl alcohol of an alcoholic strength by volume of 0% or higher** | 31 | 290,138 | 66 | 4,228,032 |
| **Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80%** | 7 | 18,753 | 10 | 3,740 |
| **Vermouth & other wine of fresh grapes flavoured with plants or aromatic substances** | 2 | 404 | 7 | 1,884 |
| **Vodka** | 62 | 7,152 | 119 | 36,192 |
| **Whisky** | 446 | 149,410 | 453 | 468,433 |
| **Wine of fresh grapes, including fortified wines** | 56 | 114,936 | 70 | 20,791 |
| **Total** | 864 | 1,386,678 | 1,036 | 4,859,105 |

*Source: Illicit Trade Report (World Customs Organisation, 2014)*

As has been mentioned above, the WCO study does not provide a breakdown by country. However, it does include some case studies, two of which relate to EU countries, namely Bulgaria and Italy.

**Bulgaria**
The Bulgarian customs authority reported that a road-stop exercise conducted in 2014 had led to the discovery in a truck of ten 1,000-litre polyvinyl chloride (PVC) containers that were being used to transport 95.8% ethyl alcohol. It was then confirmed that the proof of clearance for excise goods consumption which was supplied had been forged. The document number existed, but when both the recipient and the quantity of the goods were verified they were found to be different. The inspection of a truck in the vicinity of a tax warehouse near Sofia later that same year led to the discovery of 1,000 litres of spirits having no documentation.

**Italy**
The Italian Guardia di Finanza reported that "Operation Aida" had led to the execution of 23 arrest warrants for the promoters and participants in a transnational criminal association that was active in the production of alcoholic beverages (especially beer, vodka, whisky and wine) for a value of about €6 million worth of goods seized. The investigation was conducted jointly by members of the Guardia di Finanza and officers of the Customs and Monopolies Agency. It enabled the authorities to determine that 142 million litres of alcohol products were fraudulently consumed, amounting to €82 million worth of excise duty and VAT evasion. This scheme involved the establishment of fictitious tax warehouses (11 of them located in Italy) that seemingly received the alcohol products under the tax suspension regime. Products were received from consignors located in other EU countries, falsely stating their receipt of the goods through the misuse of the EMCS. In reality, the goods were physically transported and sold in other EU countries (e.g. the United Kingdom), which imposes a higher level of excise duty on the consumption of alcoholic beverages.

### 5.3.4 Other estimates of alcohol fraud

We now consider estimates of alcohol fraud that have been identified through our desk-based research. While it is not possible to construct a comprehensive picture of fraud across Europe from these sources, they still provide a useful cross-check of some of the estimates provided above.

The stakeholders' most recent contributions to the assessment of the size, impacts and drivers of illicit trade in alcohol, which were supplied to the Organisation for Economic Co-

operation and Development (OECD) Taskforce on charting illicit trade, included the following instances of fraudulent activity:

- In Greece, the losses from the illegal trade in alcoholic beverages, which is estimated to have grown after the excise duty was raised, were calculated (in a 2013 study) to be approximately €50 million arising from the non-payment of excise duty, while additional losses derive from the non-payment of value-added tax (VAT) in a large segment of the market[96].
- Four criminal cases in the Netherlands between 2012 and 2013 led to a recovery of €6 million in unpaid excise duties and penalties. The Dutch authorities estimate the overall extent of cross-border trade (both legitimate and fraudulent) to be worth a total of €100 million per annum.
- In Latvia, according to a 2012 report the illicit trade in alcohol represents a loss of €54 million annually in potential direct tax revenues, and much more in terms of imposing extra burdens on the social budget according to a 2012 study[97].
- Surrogates that are classified as cosmetics and then not subject to alcohol regulation comprise 7% of alcohol turnover in Lithuania.[98]
- A project carried out in 2012 by the Polish Spirits Industry in partnership with the Ministry of Finance, Customer Service and the Polish Security Printing Works showed that the loss of direct tax revenues as a result of the trade in illicit alcohol represents approximately €281 million annually.

As part of this study, we also conducted a number of interviews with relevant stakeholders. During our interview with an EU-wide trade association, it was mentioned that the Czech Republic, Hungary, Bulgaria and Romania have a significant problem with illicit alcohol. It was noted that this is partly driven by a large home-distilling culture in those countries. However, it was also noted that purchasing power in these countries is relatively low, so the excise component of the price of legitimate alcohol makes up a relatively large proportion of spending.

In the UK, the tax authority (HMRC) publishes tax gap estimates regularly. In the latest publication, it provided tax gap estimates for 2013-2014.[99] In total, it was estimated that £0.8 billion was lost in alcohol duties (excluding VAT). The table below estimates the market shares of illicit beer, spirits and wine:

**Table 21: The dimensions of the illicit market in the UK (2013-14)**

| Product | Upper estimate | Mid-point estimate | Mid-point estimate for duty losses (€) | Range of tax gap (€) (including both VAT and duty) |
|---|---|---|---|---|
| **Spirits** | 14% | 5% | €200m | €890m |
| **Beer** | 18% | 13% | €150m | €0-1,410m |
| **Wine** | 9% | 3% | €150m | €0-770m |

*Source: HMRC (2015) Measuring tax gaps, 2015 edition. Tax gap estimates for 2013-14*
*Note: GBP converted to EUR at a market rate of 1:1.23.*

As is evident, **our estimates using the tax receipts and survey results are broadly in line with these tax gap estimates**.

[96] Foundation for Economic and Industrial Research (2013) "The Spirits Sector in Greece".
[97] "Impact of Changes in Excise Tax Rate for Strong Alcohol on Consumption and State Revenues in Latvia" (2012). Published by World Academy of Science, Engineering and Technology, Paris 2012.
[98] Lithuanian Free Market Institute (2012), "Lithuanian Shadow Economy".
[99] HMRC (2015) "Measuring tax gaps 2015 edition Tax gap estimates for 2013-14".

## 5.4 Volume of fraudulent use of denatured alcohol

As can be seen from the previous section, the **issue of alcohol fraud is non-trivial in magnitude in a number of Member States**, most notably in relation to spirits. While the data on overall levels of fraud varied, the evidence presented above provides a useful indication on the potential upper bounds of any estimates of fraudulent use of denatured alcohol (in a bid to take advantage of exemptions for denatured alcohol and therefore circumvent the tax system). In this section, we narrow our focus again and present evidence on the instances of fraudulent use of denatured alcohol.

Given the difficulties inherent in measuring overall levels of fraud, it is important to recognise that the associated constraints are even more applicable to this particular type of alcohol fraud. In order to compensate for the paucity of reliable estimates of the abuse of exemptions for denatured alcohol, we analysed a variety of evidence in order to generate range estimates for the volume of fraudulent denatured alcohol in circulation, and hence the potential tax implications of this form of illicit activity. Here, it is worth noting that denatured alcohol, when found, is often not tested under laboratory conditions, and therefore, some of the counterfeit alcohol represented in the overall levels of fraud in the previous section could be denatured alcohol but may not be reported as such.

We present below the best estimates we were able to generate using results from the survey and data on seizures[100].

### 5.4.1 Estimates from tax authorities

During the stakeholder consultation, the Member States were asked to provide estimates of how much of the **duty loss due to fraudulent activity** (in the latest year) **relates to abuse of the exemptions for denatured alcohol**. Twelve of the Member States provided responses. As can be seen below, this route is **generally considered to be of low significance in terms of the overall levels of fraud** but with clear exceptions, notably Spain, Estonia and Poland, and, to a lesser extent, in the Slovak Republic.

We stress that the estimates below are Member States' estimates (as accessed through the survey) of the percentage of overall alcohol fraud that stems from the abuse of exemptions for denatured alcohol. Where a Member State has indicated an estimate of 61-80%, say, this does not mean that 61-80% of denatured alcohol is fraudulent, or that overall levels of fraud are at this level; rather, it simply means that out of total fraudulent activity (say 4-8% - see Table 17), 61-80% of this results from the fraudulent use of denatured alcohol.

**Table 22: Percentage of fraudulent activity relating to the abuse of exemptions for denatured alcohol**

| MS | Spirts | Intermediate products | Other fermented beverages | Beer | Wine |
|---|---|---|---|---|---|
| **CZ** | <5% | <5% | Do not know | Do not know | Do not know |
| **DE** | <5% | <5% | <5% | <5% | no answer |
| **DK** | <5% | <5% | <5% | <5% | <5% |
| **EE** | 41 - 60% | Do not know | Do not know | Do not know | Do not know |
| **ES** | 61 - 80% | <5% | <5% | 6 - 20% | <5% |
| **IT** | <5% | <5% | <5% | <5% | <5% |
| **LU** | <5% | <5% | <5% | <5% | <5% |
| **LV** | Do not know | <5% | <5% | <5% | <5% |

[100] In addition to these sources, we also considered data on the use and trade of denatured alcohol in the Eurostat Prodcom database. However, these data are not conclusive to producing estimates of fraudulent use of denatured alcohol.

| | | | | | |
|---|---|---|---|---|---|
| **PL** | 41% - 60% | 21% - 40% | <5% | 6% - 20% | 6% - 20% |
| **SE** | Do not know | <5% | <5% | <5% | <5% |
| **SI** | <5% | <5% | <5% | <5% | <5% |
| **SK** | 6 - 20% | Do not know | Do not know | Do not know | Do not know |
| **UK** | <5% | <5% | <5% | <5% | <5% |

*Source: Survey to Member States*

Applying these estimates to those we derived earlier for the excise duty gaps reported by Member States, we are able to derive the following estimates of the tax lost due to the fraudulent use of denatured alcohol:

**Table 23: Estimates of the tax gap (volumes in hectolitres and duty in millions of Euros) attributable to the abuse of denatured alcohol exemptions**

| | Spirits | | Intermediate products | | Wine | | Beer | |
|---|---|---|---|---|---|---|---|---|
| | Volume | Duty | Volume | Duty | Volume | Duty | Volume | Duty |
| **CZ** | 0 - 4.7 | 0 - 0.49 | 0 - 0.2 | 0 - 0.00 | NA | NA | NA | NA |
| **DE** | 0 - 31.6 | 0 - 4.12 | 0 - 2 | 0 - 0.03 | NA | NA | 0 - 17,300 | 0 - 1.36 |
| **DK** | 0 - 1.5 | 0 - 0.31 | 0 - 0.5 | 0 - 0.01 | 0 - 22.4 | 0 - 0.45 | 0 - 332 | 0 - 0.25 |
| **EE** | 12.5 - 36.6 | 2.36 - 6.92 | NA | NA | NA | NA | NA | NA |
| **ES** | 662.8 – 1,160 | 60.5 - 106 | 0 - 32.7 | 0 - 0.2 | 0 | 0 | 3,120 - 13,900 | 2.33 - 10.4 |
| **IT** | 0 - 11.6 | 0 - 1.2 | NA | NA | 0 | 0 | 0 - 1,920 | 0 - 1.15 |
| **LU** | 0 - 0.7 | 0 - 0.07 | 0 - 0.3 | 0 - 0.00 | 0 | 0 | 0 - 126 | 0 - 0.01 |
| **LV** | –NA | NA | 0 - 0.9 | 0 - 0.01 | 0 - 4.3 | 0 - 0.03 | 0 - 132 | 0 - 0.05 |
| **PL** | 554 - 1080 | 75.6 - 147 | NA | NA | 55.6 - 365 | 0.21 - 1.38 | 10,700 – 71,200 | 1.99 - 13.3 |
| **SI** | 0 - 0.3 | 0 - 0.04 | 0 - 0.04 | 0 - 0.00 | 0 | 0 | 0 - 132 | 0 - 0.16 |
| **SK** | 13.3 - 59.4 | 1.44 - 6.41 | NA | NA | NA | NA | NA | NA |
| **UK** | 0 - 44.2 | 0 - 15.7 | 0 - 17.7 | 0 - 0.83 | 0 - 434 | 0 - 19.5 | 0 - 14,600 | 0 - 34.5 |

*Source: Europe Economics analysis based on TAXUD data and survey results.*
*Note 1: ES, HR, IT, LU and SI have zero excise duty on wine.*
*Note 2: Estimates presented to three significant figures.*

When considering these estimates, it is important to bear in mind the caveats already noted in relation to the volumes of overall fraud that we estimated using the tax gap estimates provided by Member States. In particular, it is important to note that the estimates above are likely to overestimate the tax gaps due to fraud, insofar as the Member States' estimations of tax gaps do not account for the phenomenon of price elasticity of demand, which would be likely to reduce the level of consumption somewhat if illicit alcohol was substituted with taxable legitimate alcohol sold at a higher price.

### 5.4.2 Extrapolation to the EU28

Drawing on the results above, we have estimated the overall level of fraud in the EU through extrapolation.

**Fraud**

The starting point for our estimate of the overall fraud level is the Member States consultation. Out of the 28 Member States, 19 provided some estimate of the tax gap as a percentage of the total potential tax liability. Generally, if a country did not provide an estimate, we assumed that the extent of duty loss due to fraud was less than 4% of the total tax receipts unless there was evidence to indicate otherwise. In this context, we

took into account seizure data, interviews with trade associations, estimates from past studies (e.g. the WHO's data concerning unrecorded alcohol consumption) and other relevant evidence.

Using this information, we adjusted the estimated percentage of spirits fraud for Romania, Greece, Finland and beer for Sweden from the default range to 16-20%. We settled on 16-20% because their figures for unrecorded APC all lie broadly in this range. We have adjusted the beer estimate for Sweden to account for the fact that the seizure data shows a greater proportion of beer products.

**Table 24: Tax gap as a percentage of total potential tax liability (used for fraud estimation)**

| | Sprits duty | Intermediate products duty | Wine duty | Beer duty |
|---|---|---|---|---|
| **AT** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **BE** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **BG** | 12% - 16% | 0% - 4% | 0% - 4% | 0% - 4% |
| **CY** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **CZ** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **DE** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **DK** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **EE** | 4% - 8% | 0% - 4% | 4% - 8% | 0% - 4% |
| **EL** | 16% - 20% | 0% - 4% | 0% - 4% | 0% - 4% |
| **ES** | 12% - 16% | 16% - 20% | 0% - 4% | 12% - 16% |
| **FI** | 16% - 20% | 0% - 4% | 0% - 4% | 0% - 4% |
| **FR** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **HR** | 16% - 20% | 0% - 4% | 0% - 4% | 0% - 4% |
| **HU** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **IE** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **IT** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **LT** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **LU** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **LV** | 12% - 16% | 0% - 4% | 0% - 4% | 0% - 4% |
| **MT** | 4% - 8% | 8% - 12% | 16% - 20% | 4% - 8% |
| **NL** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **PL** | 12% - 16% | 12% - 16% | 4% - 8% | 4% - 8% |
| **PT** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **RO** | 16% - 20% | 0% - 4% | 0% - 4% | 0% - 4% |
| **SE** | 0% - 4% | 0% - 4% | 0% - 4% | 16% - 20% |
| **SI** | 0% - 4% | 0% - 4% | 0% - 4% | 0% - 4% |
| **SK** | 12% - 16% | 0% - 4% | 0% - 4% | 0% - 4% |
| **UK** | 4% - 8% | 0% - 4% | 4% - 8% | 12% - 16% |

*Source: Europe Economics analysis based on TAXUD data and survey results.*

### Denatured alcohol

The Member States were asked to provide estimates of the percentage of the overall tax gaps (presented above) that result from the abuse of exemptions for denatured alcohol. Here, we adopted a similar methodology specifically for denatured alcohol, just as we did for overall levels of fraud. This was in order to fill gaps where a Member State did not provide an answer; unless we had evidence of a reason to do otherwise, we chose the

zero to 5% range as the default. We believe this is a reasonable assumption, as the survey results indicate that this type of fraud is of generally low significance.

The same data sources were consulted to consider adjustments to our baseline. We accordingly raised the estimates of the share of fraudulent use of denatured alcohol within fraud overall for spirits in Cyprus and beer from the Czech Republic estimate for beer from the default zero to 5% to 61 to 80%. This is because both countries had indicated that the problem of the abuse of denatured alcohol exemption was significant. Spain, whose authority had classed the problem as moderately significant, estimated that the 61 to 80% of the tax loss experienced in spirits was attributable to the abuse of exemptions for denatured alcohol. A conservative inference for Cyprus would be 61 to 80%. We have inferred only the value for beer in the case of the Czech Republic because the Czech authorities provided their own estimates for spirits and intermediate products. Again, we stress here that these estimates are not indicators of the overall level of fraud. Rather, these estimates represent the proportion of the tax gap resulting from fraudulent activities in general (which is generally estimated to be very low – see Table 17) that can be attributed to the abuse of exemptions for denatured alcohol.

**Table 25: Percentage of the overall tax gap resulting from the abuse of exemptions for denatured alcohol**

| MS | Spirts | Intermediate Products | Wine | Beer |
|---|---|---|---|---|
| **AT** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **BE** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **BG** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **CY** | 61% - 80% | 0% - 5% | 0% - 5% | 0% - 5% |
| **CZ** | 0% - 5% | 0% - 5% | 0% - 5% | 61% - 80% |
| **DE** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **DK** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **EE** | 41% - 60% | 0% - 5% | 0% - 5% | 0% - 5% |
| **EL** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **ES** | 61% - 80% | 0% - 5% | 0% - 5% | 6% - 20% |
| **FI** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **FR** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **HR** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **HU** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **IE** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **IT** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **LT** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **LU** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **LV** | 0-5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **MT** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **NL** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **PL** | 41% - 60% | 21% - 40% | 6% - 20% | 6% - 20% |
| **PT** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **RO** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **SE** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **SI** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |
| **SK** | 6% - 20% | 0% - 5% | 0% - 5% | 0% - 5% |
| **UK** | 0% - 5% | 0% - 5% | 0% - 5% | 0% - 5% |

*Source: Europe Economics analysis based on TAXUD data and survey results.*

In terms of product type, **most of the duty loss due to the abuse of exemptions for denatured alcohol is attributable to the spirits category**, as we would expect. In that category, **Poland yields the highest estimate for duty loss in monetary terms** (€76-147 million), followed by Spain (€61–€106 million). The UK is next (€0–€16 million). Finland, France, Italy and the Slovak Republic are characterised by moderate levels of duty loss in absolute terms.

**Table 26: Estimates of duty loss due to the abuse of exemptions for denatured alcohol (volumes in hectolitres and duty in millions of Euros)**

| MS | Sprits | | Intermediate products | | Wine | | Beer | |
|---|---|---|---|---|---|---|---|---|
| | Volume | Duty | Volume | Duty | Volume | Duty | Volume | Duty |
| **AT** | 0 - 2.8 | 0 - 0.34 | 0 - 1.3 | 0 - 0.01 | 0 | 0 | 0 - 1,950 | 0 - 0.39 |
| **BE** | 0 - 2.7 | 0 - 0.58 | 0 - 4.1 | 0 - 0.05 | 0 - 78.6 | 0 - 0.45 | 0 - 2,110 | 0 - 0.39 |
| **BG** | 0 - 13.7 | 0 - 0.77 | 0 | 0 | N/A | 0 | 0 - 1,040 | 0 - 0.08 |
| **CY** | 0 - 7 | 0 - 0.67 | 0 | 0 | N/A | 0 | 0 - 33.3 | 0 - 0.02 |
| **CZ** | 0 - 4.7 | 0 - 0.49 | 0 | 0 | 0 - 36.4 | 0 - 0.31 | 0 - 45,900 | 0 - 5.34 |
| **DE** | 0 - 31.6 | 0 - 4.12 | 0 - 2 | 0 - 0.03 | 0 - 60.3 | 0 - 0.82 | 0 - 17,300 | 0 - 1.36 |
| **DK** | 0 - 1.5 | 0 - 0.31 | 0 - 0.5 | 0 - 0.01 | 0 - 28.9 | 0 - 0.45 | 0 - 332 | 0 - 0.25 |
| **EE** | 12.5 - 36.6 | 2.36 - 6.92 | 0 | 0 | 0 - 7.2 | 0 - 0.07 | 0 - 125 | 0 - 0.09 |
| **EL** | 0 - 11.5 | 0 - 2.82 | 0 | 0 | N/A | 0 | 0 - 846 | 0 - 0.22 |
| **ES** | 663 - 1,160 | 60.5 - 106 | 0 - 32.7 | 0 - 0.2 | N/A | 0 | 3,120 - 13,900 | 2.33 - 10.4 |
| **FI** | 0 - 9.4 | 0 - 4.3 | 0 - 0.1 | 0 - 0.04 | 0 - 19.8 | 0 - 0.67 | 0 - 381 | 0 - 1.22 |
| **FR** | 0 - 25.9 | 0 - 4.48 | 0 - 0.9 | 0 - 0.15 | 0 - 640 | 0 - 0.24 | 0 - 2,340 | 0 - 1.73 |
| **HR** | 0 - 4.3 | 0 - 0.3 | 0 | 0 | N/A | 0 | 0 - 306 | 0 - 0.16 |
| **HU** | 0 - 3.3 | 0 - 0.35 | 0 | 0 | 0 - 3.8 | 0 - 0.02 | 0 - 556 | 0 - 0.29 |
| **IE** | 0 - 1.4 | 0 - 0.6 | 0 - 0.3 | 0 - 0.13 | 0 - 16.2 | 0 - 0.69 | 0 - 377 | 0 - 0.85 |
| **IT** | 0 - 11.6 | 0 - 1.2 | 0 | 0 | N/A | 0 | 0 - 1,920 | 0 - 1.15 |
| **LT** | 0 - 2.7 | 0 - 0.35 | 0 - 0.2 | 0 - 0.03 | 0 - 5.5 | 0 - 0.04 | 0 - 322 | 0 - 0.1 |
| **LU** | 0 - 0.7 | 0 - 0.07 | 0 | 0 | N/A | 0 | 0 - 126 | 0 - 0.01 |
| **LV** | –0 – 6.3 | 0 – 0.86 | 0 - 0.9 | 0 - 0.01 | 0 - 4.3 | 0 - 0.03 | 0 - 132 | 0 - 0.05 |
| **MT** | 0 - 0.4 | 0 - 0.05 | 0 | 0 | 0 | 0 | 0 - 57.8 | 0 - 0.01 |
| **NL** | 0 - 3.8 | 0 - 0.64 | 0 - 0.3 | 0 - 0.05 | 0 - 75.8 | 0 - 0.67 | 0 – 1,170 | 0 - 0.89 |
| **PL** | 554 - 1080 | 75.6 - 147 | 0 | 0 | 55.6 - 365 | 0.21 - 1.38 | 10,700 – 71,200 | 1.99 - 13.3 |
| **PT** | 0 - 1.5 | 0 - 0.19 | 0 - 0.2 | 0 - 0.02 | N/A | 0 | 0 - 144 | 0 - 0.14 |
| **RO** | 0 - 8.3 | 0 - 0.89 | 0 | 0 | 0 | 0 | 0 - 3,390 | 0 - 0.3 |
| **SE** | 0 - 1.5 | 0 - 0.86 | 0 - 0.1 | 0 - 0.03 | 0 - 38.3 | 0 - 1.06 | 0 - 1,740 | 0 - 3.71 |
| **SI** | 0 - 0.3 | 0 - 0.04 | 0 | 0 | N/A | 0 | 0 - 132 | 0 - 0.16 |
| **SK** | 13.3 - 59.4 | 1.44 - | 0 | 0 | 0 - 973 | 0 - 7.75 | 0 - 307 | 0 - 0.11 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | 6.41 | | | | | | |
| **UK** | 0 - 44.2 | 0 - 15.7 | 0 - 17.7 | 0 - 0.83 | 0 - 434 | 0 - 19.5 | 0 - 14,600 | 0 - 34.5 |

*Source: Europe Economics analysis based on data from DG TAXUD and survey results*

Besides the caveats mentioned in 5.3.2, we should add the following cautionary points regarding the application of these results:

- The value of the denatured alcohol may vary significantly, depending on the alcohol content. Such variations would affect our estimates of the value and volume of the fraud.
- Some of the illegal production of the denatured alcohol that gets converted into beverages may not be mass-produced by factories, but by individuals. Accordingly, it may not be included in the Member States' estimations.
- Our assumptions are limited to what we can infer or deduce from the information we have gathered or obtained.
- The estimates for most Member States' overall fraud levels and denatured alcohol fraud levels can be generalised as lying between 0to 4% and 0 to 5% respectively.

### 5.4.3 Seizures relating to denatured alcohol

Below, we present information from various different sources about seizures which yields some concrete data regarding the magnitude of several illegal operations centring on the fraudulent use of denatured alcohol.

**WCO**

The aforementioned WCO report on illicit trade includes data on the seizures of "undenatured ethyl alcohol of an alcoholic strength by volume of 80% or higher" and "undenatured ethyl alcohol of an alcoholic strength by volume of less than 80%". Following discussion with the WCO, we have established that the former (i.e. >80% strength) corresponds to HS Code 2207.10 in the WCO's "Harmonised System" (HS). The 2207 code also incorporates code 2207.20, "Ethyl alcohol and other spirits, denatured, of any strength". This code relates to alcohol used for industrial purposes, and would therefore be relevant for the assessment of the extent of the fraudulent use of denatured alcohol. However, data on seizures of this type of alcohol when intended for human consumption are not available.

As a proxy, here we therefore report the volume of seizures of "undenatured ethyl alcohol of an alcoholic strength by volume of less than 80%", as this corresponds to spirituous beverages and hence possibly to illicit alcohol derived from the fraudulent use of denatured alcohol:

**Table 27: Seizures of spirits**

| | 2013 | | 2014 | |
|---|---|---|---|---|
| | No. of seizures | Quantity (litres) | No. of seizures | Quantity (litres) |
| **Undenatured ethyl alcohol of an alcoholic strength by volume of 80% or higher** | 7 | 18,753 | 10 | 3,740 |

*Source: WCO (2015) "Illicit trade report 2014".*

When considering these numbers, it is important to remember that the data only provide a limited picture of the extent of fraud, and are based on contributions from 30 countries, not all of which are EU Member States. Nonetheless, they give some indication of its magnitude.

The WCO report also notes that "the use of surrogate alcohol (namely alcohol not originally intended for human consumption) may additionally pose health risks due to the presence of toxic denaturants or additives (present for example in cosmetic alcohol)".

**Operation OPSON**

Operation OPSON 1 started in 2011 with ten participating countries, exclusively European Member States. OPSON IV was developed in 2014 and early 2015 and encompassed 47 countries from all continents. In total, since the first operational phase, 20,171 tonnes and 1,607,449 litres of fake and substandard products have been seized or withdrawn from markets. The most recent publication reported the following in relation to seizures of alcohol:[101] an illicit factory producing fake name-brand vodka was discovered by Derbyshire County Council Trading Standards team in the UK. Officers discovered more than 20,000 empty bottles ready for filling, hundreds of empty five-litre antifreeze containers which had been used to make the counterfeit alcohol, as well as a reverse osmosis unit used to remove the chemical's colour and smell. A large quantity of fake bottle tops, hundreds of unauthorised boxes marked with the brand, and used labels were also seized. During the latest OPSON V exercise, three illicit factories producing counterfeit alcohol were discovered in Greece. Besides 7400 bottles of fake alcohol and labels, the police also seized other equipment used for the manufacturing process. In the UK, authorities recovered nearly 10,000 litres of fake or adulterated alcohol, including wine, whisky and vodka.

**The Royal United Services Institute**

The Royal United Services Institute (RUSI) recently published its study on organised crime and the illicit trade in tobacco, alcohol and pharmaceuticals in the UK[102]. The authors' research found that the illicit alcohol trade primarily consists of the distribution of duty non-paid goods; counterfeiting is relatively rare (notwithstanding the Derbyshire case mentioned immediately above), but entails significant scales of production. Cases often only come to light after some sort of incident. The most high-profile case in recent years was in July 2011, when five Lithuanian men died in an explosion at an illicit vodka distillery in Boston, Lincolnshire.

Operation Baygood was an investigation by HMRC into the production, bottling and distribution of commercial quantities of counterfeit Glen's vodka on which duty had not been paid. Officers found a complete vodka production line with all the necessary equipment including international bulk containers, several thousand litres of counterfeit vodka, twenty full pallets and two part pallets of empty bottles ready for bottling, and a substantial stainless steel header tank with a capacity of 6,000 litres. This was not the first time that officers had come across the counterfeit Glen's vodka. In May 2009, in excess of 5,000 litres were seized at a storage unit in Blackpool, thought to be from the same source, and in July 2009, officers at Coquelles (the Eurotunnel terminal) intercepted a Polish-registered van travelling to the UK with a consignment of more than 100,000 counterfeit Glen's bottle tops, and two weeks later, officers at Coquelles intercepted a Polish-registered bus travelling to the UK with approximately 29,500 counterfeit Glen's bottle tops.

There have been cases in Cheetham Hill, where in October 2010 HMRC officers seized 25,000 litres of counterfeit vodka, bottling and labelling equipment, and Worcestershire, where in March 2011, more than 11,400 litres of counterfeit alcohol were seized at an industrial unit.

It is not clear that these cases necessarily relate to the use of denatured alcohol in the UK; however, it is possible that this was the approach taken, and in any case the seizures above are indicative of the scale of counterfeiting operations that have been found in the UK.

**Member State questionnaire**

Member States were asked to provide their best estimate of the detection rate (as a percentage) of the illegal use of denatured alcohol, completely denatured alcohol and alcohol exempted under Article 27.1 (b). Other than Spain and Poland, no Member States

[101] Interpol and Europol (2015) "Operation OSPON IV".
[102] RUSI (2014) "On Tap: Organised Crime and the Illicit Trade in Tobacco, Alcohol and Pharmaceuticals in the UK".

provided any numbers. Spain's estimates for rates of detection are 45%, 10% and 45% respectively. Poland's estimates for rates of detection are 15% for the illegal use of denatured alcohol and 15%for the illegal use of completely denatured alcohol.

## 5.5 Supply chain sources of denatured alcohol

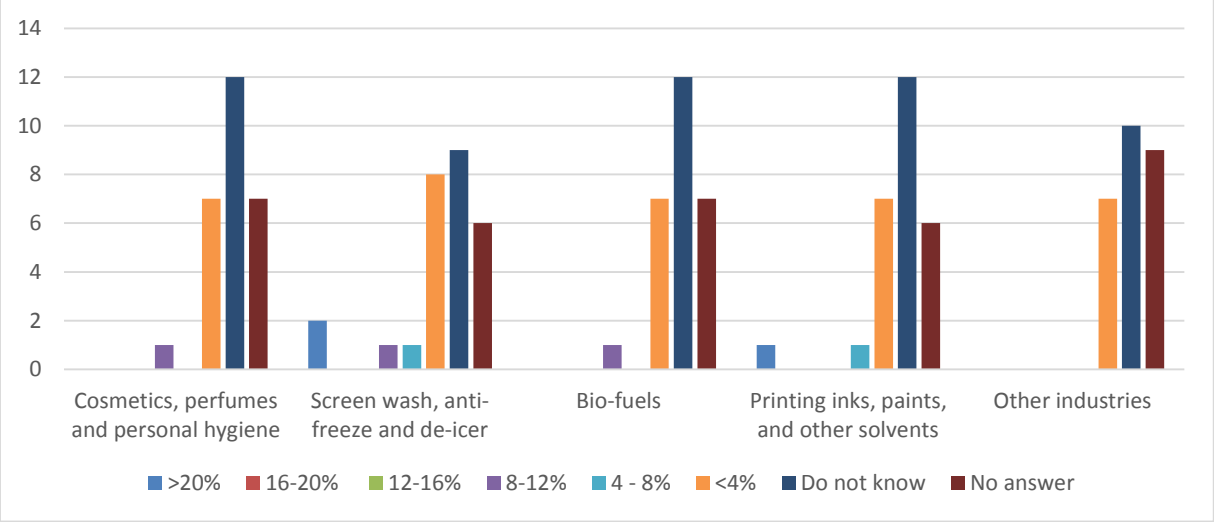
Having established that **a degree of fraudulent use of denatured alcohol stems from the excise duty structures currently in place**, a subsidiary question is whether there are particular sources of this fraud that are more prevalent than others, i.e. the extent to which denatured alcohol is being **diverted from the supply chains** for particular products in order to produce counterfeit potable alcohol.

We conducted an interview with scientists from the Joint Research Centre, who noted that the processes that criminals use when dealing with denatured alcohol are uncertain, but that fraudsters likely use techniques such as precipitation (particularly for removing tasting agents) or passing the liquid through charcoal (particularly for removing the smell agents) to clean up the alcohol as much as possible by removing denaturants that create a bitter taste and certain smells. Reverse osmosis is also being used to remove common salt-based denaturants. All of these methods are relatively inexpensive (e.g. reverse osmosis kits can easily be obtained at low cost on retail sites)

The JRC's opinion was that denatured alcohol itself is often obtained in the form of burning alcohol (i.e. alcohol as a fuel) and screen wash. These may be obtained legitimately, though it is not clear how larger quantities (e.g. those contained and transported in industrial bulk containers) are obtained. The JRC's view was that burning alcohol might normally be cleaned up and diluted twice to get it to 40% for use in something like fake vodka; i.e., five litres of burning alcohol could be used to generate 10 litres of fake vodka. Sources such as screen wash are typically at 40% strength already; fake vodka made using screen wash would often be weaker than 40%, as some alcohol is generally lost through the cleaning process.

As set out in section 5.2.3, Member States were asked to estimate (if they could) the extent to which denatured alcohol is being diverted from within the supply chains of particular products. The Estonian authority noted that ignition liquid was also a relevant source, and the Czech authority noted that in most recent years denatured alcohol was diverted particularly from products such as screen wash, anti-freeze and de-icer in order to produce illegal spirits (which is partially supportive of the JRC's view). The overall results are shown in the chart below:

**Figure 39: The extent to which Member States believe denatured alcohol is being diverted from within the supply chains of different products**



As can be seen above, the majority of Member States responded that they did not know, or else did not provide an answer. Of those Member States that did respond, most thought that less than 4 per cent of the denatured alcohol in any given supply-chain was being diverted towards illegitimate ends. It is unclear where those countries fall within the less than 4 per cent band. Between one and three Member States identified higher rates of diversion in the four identified industrial groupings

The evidence from Member States is not suggestive of any systematic diversion of denatured alcohol from any one supply chain in particular.

Overall, therefore, the evidence on which supply chains denatured alcohol is being diverted from is fragmentary and idiosyncratic. As such it is unlikely to be of material consequence in assessing the impacts of fraudulent use of denatured alcohol as a result of the Directive. In any case, the problem does not appear to be sufficiently large so as to have industry-specific denaturants that could be traced properly (especially as laboratories to undertake this type of assessment are not commonplace).

# 6. Establishment of duty on beer

This chapter presents our findings regarding the rules for the establishment of duty on beer.

The Directive gives the Member States the choice about whether to levy excise duty on beer on the basis either of the number of hectolitres/degrees Plato or the number of hectolitres/degrees of actual alcohol strength by volume. Those Member States that levy the duty in terms of the number of hectolitres/degrees Plato may divide beer into categories of degree and apply different rates to these categories (Article 3.2).

## 6.1 Summary of findings

**The coexistence of two different methods of establishing the duty on beer creates no major difficulties or negative consequences.** The views expressed by the Member States, as well as by producers of beer and the associations representing them show clear agreement on this matter.

**The current provisions of Directive 92/83/EC on establishing duty for beer continue to remain appropriate, in their current form.** The Member States are currently free to apply whichever method they deem more appropriate. There is no evidence that by doing so they are negatively affecting other Member States or operators established in other Member States.

**The understanding of Article 3.1 with regard to at what point in the production process the degree Plato should be measured differs between the Member States.** An analysis of how Article 3.1 is implemented shows that the interpretation of this Article among those Member States that apply excise duty on beer on the basis of degrees Plato differs. This is relevant in the production of beer mixes with added sugar-sweetened content. While some Member States take as their reference value the degrees Plato prior to the addition of sugar as a reference, but after fermentation stops, others use degrees Plato of the final product. The difference is material, since the addition of sugar increases the degrees Plato but not the alcoholic content of the beer, and results in different excise rates applicable for the products in question.

**Finally, practical difficulties in the functioning of the EMCS have been reported to be leading to unnecessary administrative burdens on the Member States and economic operators.** Economic operators are obliged to include information on the alcoholic percentage of their products in the EMCS, even when the movement takes place between countries which only apply the Plato method.

## 6.2 Analysis of evidence

For half of the Member States responding to the questionnaire, the choice between setting their excise duty on beer using the Plato method versus the one based on alcohol strength was based on **tradition**. These Member States chose the method they had been using before the Directive was introduced. The Member States using the Plato method argued that it took the **particularities of the brewing process** into account better, and that from a technical point of view, alcohol strength is more difficult to measure consistently.

Those Member States which set their beer excise duty based on alcohol strength noted that this method made the duty on beer more **comparable with the other product categories** of the Directive, and that it responded better to the requirements of **health policy** by ensuring that the duty to be paid was directly proportionate to the alcohol strength.

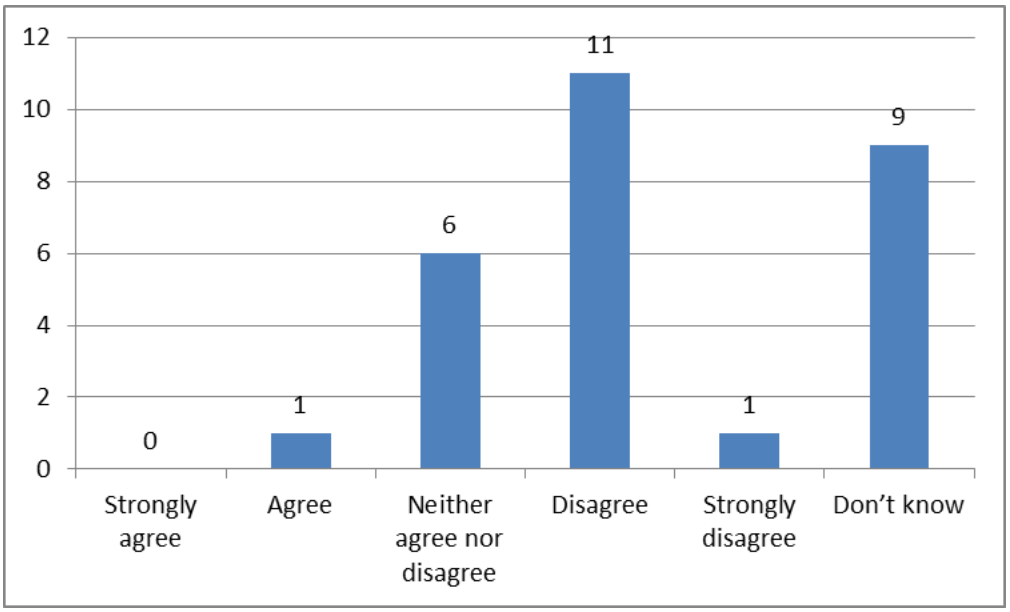
One Member State (DK) indicated that in 2003 it had switched from using the Plato method and five different excise categories to an excise duty based on alcohol strength.

This change allowed **increased competition**, as producers had more flexibility regarding the excise to be paid, depending on the alcohol strength of their product.

As Figure 40 shows, when they were asked whether the provision of two different methods for establishing excise duty for beer led to unfair tax competition between countries, twelve of the Member States indicated that they did not observe any unfair tax competition (AT, CZ, DK, EL, ES, HU, IE, IT, LU, PL, RO, SI). Most of them pointed out that excise duty only becomes due in the Member State of the release for consumption, and that there was therefore **no incentive to move the place of production**. In addition, several Member States mentioned that the excise duty on beer was rather low, making the differences in excise rates across the Member States much more significant than the method used to calculate them.

Only one Member State (SE) argued that there would be unfair tax competition due to the two methods. Its administration commented that in a harmonised system only one method should be permitted, and that measuring alcohol strength would be more appropriate for taxation purposes than the Plato method.

**Figure 40:** ***The availability of two different methods for setting excise duty on beer leads to unfair tax competition between countries, e.g. when producers base their location and investment decisions on this factor***



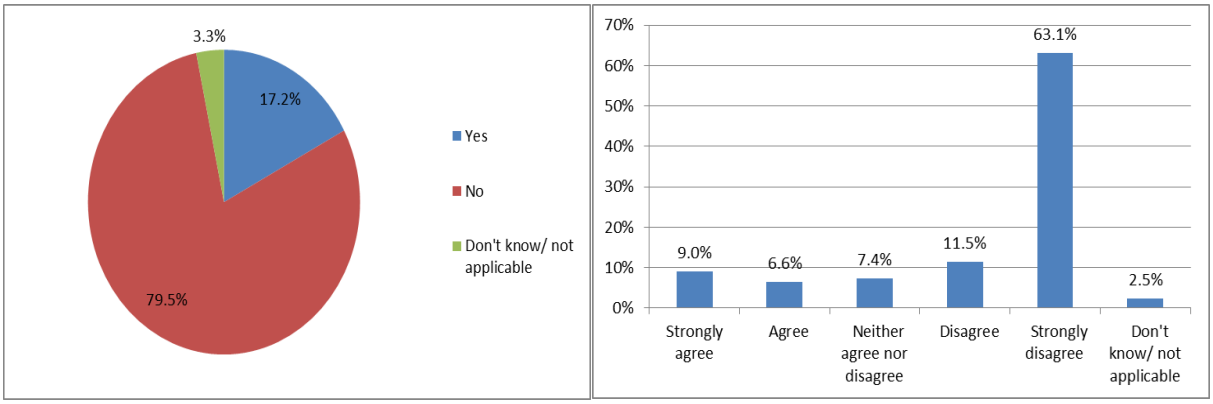

*Source: Survey to Member States*

As Figure 41 shows, when the responses of industry are analysed, we can observe that a broad majority of beer producers and their representative associations thought there was **no advantage in using one of these methods** for calculating the excise duty on beer rather than the other (80%).

When they were asked whether the use of one method over another produced any competitive disruptions or tax advantages, only a small percentage (14% and 16%[103] respectively) of beer producers and their representative associations believed this to be the case.

[103] These results are not illustrated graphically, for the sake of brevity.

**Figure 41:** ***Do you believe that one particular method of calculating excise duties on beer (by reference to the number of hectolitres/degrees Plato versus the number of hectolitres/degrees of actual alcohol strength by volume) has an advantage over the other / creates competitive disruptions between beer producers that are taxed differently?***[104]




*Source: Survey to economic operators, August-November 2015.*

An analysis of the open-ended answers given by the alcohol industry to back up their opinions shows that a large majority of the stakeholders have agreed to adopt a common position which supports the **long-standing tradition of using the Plato system**, and believe there is no evidence that the coexistence of the Plato and ABV systems for calculating beer duty in the European Union causes any distortions in the internal market. This group points out that as duty is paid in the Member State of consumption, government revenues are not affected, and it considers that the decision about which method is more appropriate for their needs should be left up to the Member States in question. Additionally, a number of stakeholders also considered the Plato method to be easier to implement, as the alcoholic content may differ slightly from batch to batch due to the characteristics of the yeast used in the brewing process.

However, when we consider the reasoning of that minority of beer producers and their associations which takes the opposite view, we can note their opinion that there is **no objective justification for applying two methods** of calculation for a single product, and that the number of hectolitres/degrees of actual alcohol strength by volume is a more transparent and less objectionable system for calculating excise duties on beer, because it increases the coherence of the methods used to calculate the excise duties applicable to the different types of alcoholic beverage.

In practice, the use of the Plato method has been reported to be **problematic for the production of beer mixes with added sugar-sweetened** content. Article 3.1 of the Directive states that excise duty levied on beer shall be fixed by reference either

(i) to the number of hectolitre / degrees Plato or

(ii) to the number of hectolitre / degrees of actual alcoholic strength by volume of finished product.

Member States do not agree whether the term "finished product" also applies to the measurement by degree Plato. The interpretation becomes important in the case of beers to which sugar has been added. The sugar increases the degree Plato of the product while not increasing its alcohol strength. That means the excise duty potentially increases for products which do not contain a higher alcoholic strength.
Several beer producers reported that this **created unfair competition**, in particular in comparison to beer mixes which contain artificial sweeteners instead of sugar. For the latter products the increased tax rate would not apply. If the degree Plato is measured only for the beer content before the addition of any other content, the explained difficulties do not apply.

[104] Questions were posed only to beer producers and their representing associations, n=122

As a separate issue, one Member State has also reported that the existence of different methods for setting the duty on beer creates a **practical problem connected with the way the EMCS functions**. This is because according to Regulation 684/2009[105], the alcoholic content of beer moving under duty suspension has to be specified; however, this data is not relevant for movements between countries which only apply the Plato system, yet the operators are still required to indicate the alcohol content. This problem is aggravated by the fact that there is no legally validated correlation between degrees Plato and alcohol strength.

[105] Annex II, "List of codes" Commission Regulation (EC) No 684/2009 of 24 July 2009 implementing Council Directive 2008/118/EC as regards the computerised procedures for the movement of excise duty goods under suspension of excise duty.

# 7. External Coherence

In this section, we assess the external coherence of the provisions of the Directive with other EU legislation and international agreements. Specifically, we have adopted the following approach which is reflected in the structure of this section:

- Our first step is to assess the coherence of the product classification system specified in the Directive with the classification system that is used for customs purposes in the EU.
- Second, we list the references to EU legislation that have changed since the Directive came into force.
- In a third section, issues involving the coherence of the treatment of wine precursors are described.

## 7.1 Summary of findings

**Overall, the Directive has shown to be coherent with EU and international legislation.** No problems with regard to the internal coherence of the Directive have been identified.

**Specific issues identified were primarily linked to changes in the Combined Nomenclature and amendments to EU legislation since the introduction of the Directive**. These outdated references in the Directive were not reported by the stakeholders as a source of problems.

**In its definition of sparkling wine and sparkling other fermented beverages the Directive is neither coherent with the CN of 1992, nor with the current one.** Again, none of the consulted stakeholders reported any practical problem related to this incoherence.

**The CN codes which can be used for denatured alcohol are not clearly defined**. There are differences among the Member States with regard to when CN 3814, 3820 and 3824 can be used. This does create practical issues for economic operators.

**The treatment of precursors of wine was reported to be problematic by two Member States.** While must and juices which will become wine are not defined in the Directive, they have to, in some situations be moved under the cover of an accompanying document. However, beside the Member States, no stakeholder reported any problems with the treatment of these products.

## 7.2 Coherence with the classification system used for customs

The definition of product categories in the Directive is based on the CN that is used to classify products for customs purposes. This system was chosen because it provides a comprehensive classification of alcohol and alcoholic beverages. In turn, the CN codes use the Harmonised System (HS) nomenclature of the World Customs Organisation (WCO). Article 26 of the Directive states that references to CN codes shall be to "*those of the version of the Combined Nomenclature in force when the Directive is adopted*". Because the CN codes have been subject to annual review, some individual referents in the various Articles that classify products no longer exist in the current version of the CN, namely 2204 21 10 (Articles 8.2 and 12.2) and 2206 00 91 (Article 12.2).

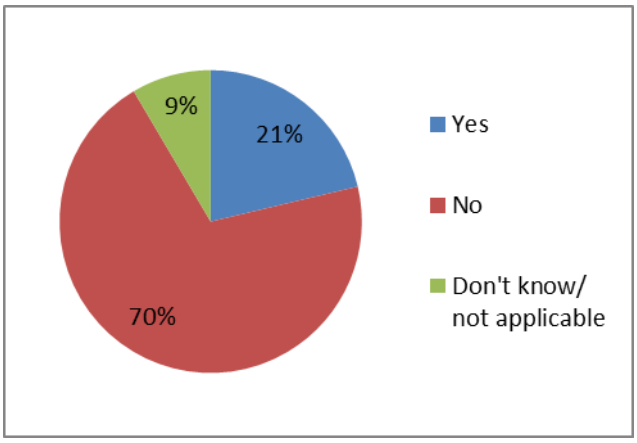
Article 8.2 defines **sparkling wine** as having "*an excess pressure due to carbon dioxide in solution of three bar or more*". The definition refers to the outdated 2204 21 10 CN code, as well as to 2204 29 10. Meanwhile, in the CN codes dating from 1992[106], products

[106] Commission Regulation (EEC) No 2505/92 of 14 July 1992 amending Annexes I and II to Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff; Chapter 22

falling under these two codes are defined as having "an excess pressure due to carbon dioxide in solution of not less than 1 bar but less than 3 bar". The same CN codes are also used in Article 12.2 to describe **other sparkling fermented beverages** which are also defined in the Article as having an excess pressure of at least 3 bar, in accordance with the definitions provided for sparkling and aerated sparkling wines in the Common Market Organisation (Regulation 1308/2013). Such definitional incoherence has the potential to create uncertainty regarding how to classify a sparkling fermented beverage or sparkling wine with an excess pressure below 3 bar.

Furthermore, in the additional notes to CN codes of 1992, the products defined by CN 2206 00 91 are described as having an excess pressure of not less than 1.5 bar. This code is also used in Article 12.2 to describe other sparkling fermented beverages. Again, there is a discrepancy concerning the minimum excess pressure required for a beverage to be described as 'sparkling'.

**Figure 42:** ***Have you encountered problems with regard to the way denatured alcohol can be classified in the CN code system?*** **(N=47)**




*Source: Survey to economic operators, August-November 2015.*

Another issue linked to the coherence with the classification of products for customs purposes relates to **denatured alcohol**. Several other CN codes are used for products containing denatured alcohol besides 2207 20 ("ethyl alcohol and other spirits, denatured, of any strength"), namely CN codes 3814 ("organic composite solvents and thinners; prepared paint or varnish removers"); 3820 ("anti-freezing preparations and prepared de-icing fluids"); and 3824 ("prepared binders for foundry moulds or cores; chemical products and preparations of the chemical or allied industries").

Several economic operators and Member States reported difficulties with regard to the CN classification of denatured alcohol for customs purposes (see Figure 42). Specifically, economic operators producing biofuels, denatured alcohol, printing inks, and paints and other solvents, reported encountering issues with the classification of denatured alcohol in the CN code system. More than 50% of respondents from each of these sectors reported that they had encountered difficulties.

Users of denatured alcohol indicated that in some Member States it was possible to get alcohol exempted from tax supervision by using one of the CN codes relating to a different product containing denatured alcohol. Getting a product recognised as something other than denatured alcohol confers the clear advantage of less administrative requirements or supervision. At the same time, this raised the concern among some Member States and economic operators that the limited supervision could produce an increased fraud risk.

To sum up, none of the economic operators or the Member States indicated that the references to outdated CN codes and the inconsistencies with regard to the minimum excess pressure in sparkling beverages were creating any practical problems, for instance with regard to differences in treatment between products from the EU and third counties. Nevertheless, if it was decided to review the Directive, coherence should be established in order to avoid problems in the future. With regard to the CN codes for denatured alcohol, further investigation of potential resolutions of the issue is recommended in order to promote a consistent interpretation of the definition of denatured alcohol and the other CN codes, so as to ensure that economic operators are treated fairly and fraud risks are minimised.

## 7.3 References to outdated legislative acts

The Directive contains references to several legislative acts which have been amended or repealed since 1992. Table 28 below presents an overview of the references in the Directive to legislation which is no longer in force.

**Table 28: Overview of references to outdated legislative acts**

| Concerned legislative act | Article | Status | New legislative act |
|---|---|---|---|
| **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** | Article 15<br>Article 27.1 (a)<br>Article 27.4<br>Article 27.5 | Replaced | Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC |
| **Council Regulation (EEC) No 4252/88 of 21 December 1988 on the preparation and marketing of liqueur wines produced in the Community** | Article 18.4 | Repealed | Commission Regulation (EC) No 607/2009 of 14 July 2009 laying down certain detailed rules for the implementation of Council Regulation (EC) No 479/2008 as regards protected designations of origin and geographical indications, traditional terms, labelling and presentation of certain wine sector products |
| **Council Regulation (EEC) No 1576/89 of 29 May 1989 laying down general rules on the definition, description and presentation of spirit drinks** | Article 23 | Repealed in 2008 | Replaced by Regulation (EC) No 110/2008 of the European Parliament and of the Council of 15 January 2008 on the definition, description, presentation, labelling and the protection of geographical indications of spirit drinks and repealing Council Regulation (EEC) No 1576/89 |
| **Council Directive 65/65/EEC of 26 January 1965 on the approximation of provisions laid down by law, regulation or administrative action relating to proprietary medicinal products** | Article 27.1 (d) | Repealed in 2001 | Replaced by Directive 2001/83/EC of the European Parliament and of the Council of 6 November 2001 on the Community code relating to medicinal products for human use |

None of these obsolete references have been reported as creating problems for the Member States or economic operators. (n.b. – no specific questions were posed to stakeholders in relation to these references, so the problem could be under-reported.) Nevertheless, if it was decided to review the Directive, these references could be updated in the interest of transparency.

## 7.4 Management of wine precursors

Another issue concerning coherence relates to the management of wine precursors (i.e. must and juices which are to be turned into wine). Must and juices are not excisable products in terms of the Directive, but reportedly must be moved with an accompanying document, just like excisable products. Two Member States (FR and EL) reported that they had encountered problems in connection with these products. The French authorities noted that some economic operators which lack the standing to issue or receive electronic administrative documents (e-AD) through the EMCS and usually do not require it are in a difficult position when they receive must from another Member State that is accompanied by an e-AD, as they lack the access to EMCS to clear the movement. The Greek authorities reported that they had only recently introduced excise duties on wine and

other fermented beverages. The need to monitor wine precursors had therefore subsequently arisen. The authorities suggested that monitoring the movements of these products would be made easier by requiring accompanying documents under Directive 2008/118/EC.

# 8. To what extent does the Directive respond to the needs of the Member States with regard to the protection of public health?

This section presents the findings of the evaluation with regard to the Member States' scope for ensuring the protection of public health in the context of the structures laid down by the Directive. The Member States' tax authorities, which were consulted by means of a questionnaire for this evaluation, were invited to involve their health authorities when responding. Half of the Member States specifically indicated that they did so; for the remaining fourteen Member States, it is not clear whether a consultation of their health authorities did actually take place.

In its preamble, Directive 92/83/EEC sets out its objective of ensuring the proper functioning of the internal market. Supporting Member States in their **health policy objectives is not referred to as one of its aims**. In fact, Directive 92/84/EEC setting minimum excise rates for alcoholic beverages also contains no explicit reference to the protection of public health either.

Nevertheless, there are **Member States which explicitly use excise duty on alcoholic beverages as one of their methods of reducing alcohol-related harm**.[107] Through increasing the taxation of alcoholic beverages, governments are aiming to reduce (harmful) consumption. In addition, EU legislation has evolved since the Directive was introduced, and it now requires all the Union's policies and activities to ensure a high level of human health protection[108] and taking into account article 168 (5) where the measures which have as their direct objective the protection of public health regarding the abuse of alcohol.

The impact of consumption of alcohol on consumers' health, and the possibility of influencing consumer behaviour effectively using the instrument of excise duty rates, has not been researched within the context of this study. This section covers the perceived impacts that the provisions of Directive 92/83/EEC have on the ability of the Member States to pursue health objectives, by using excise policy as a tool, if they should wish to do so. The findings have influenced the conclusions on the relevance of the Directive's provisions.

## 8.1 Summary of findings

**The Directive does not mention consumer health protection as being one of its objectives.** However, it may be noted that the legislative context of the Directive has arguably evolved since its introduction, and that ensuring a high protection of human health in all the EU's policies and activities has become enshrined in the EU treaty.

**The Member States have opposing views on whether the Directive can and should be used to achieve health policy objectives**. They are pursuing divergent interests when imposing excise duty on alcohol and alcoholic beverages. Many Member States noted that the Directive was neutral with regard to health policy. Half of the Member States report that the Directive allows them to use excise duties on alcohol as a policy tool to protect consumer health, while six noted that the Directive hindered them in achieving their national health policy objectives.

**From the perspective of health policy, Member State authorities criticised the use of different categories for alcoholic beverages instead of a consistent classification of products based on their alcoholic strength, the provision of**

[107] European Commission (2006): Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – An EU strategy to support Member States in reducing alcohol-related harm; COM(2006) 625 final

[108] Treaty on the Functioning of the European Union, Article 168.1

**reduced rates for small producers, and exemptions for private production.** They expressed the concern that because these provisions would lead to lower taxation and hence lower prices, they could make alcohol and alcoholic beverages more affordable. Reduced rates for products of low alcoholic strength were assessed positively by these authorities.

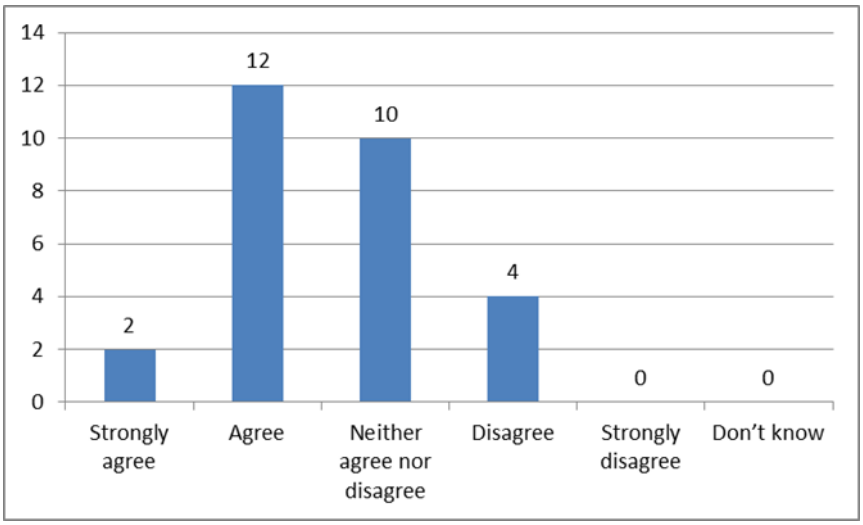
**Consumers and associations of medical doctors and dentists have stated their clear expectations that the Directive should respond to alcohol-related health risks.** Academics and professional medical associations have drawn attention to recent research showing the link between consumption and the pricing of alcohol influenced by excise duty. Against this background, the Directive was criticised for its anomalous taxation of different alcohol products, and for giving insufficient incentive for the production and purchase of lower-strength alcohol. These concerns were not expressed by private companies or industry associations.

## 8.2 Linking the Directive to health policy

The Member States are pursuing divergent interests in their impositions of excise duty on alcohol and alcoholic beverages. These different considerations also have an influence on the authorities' views regarding the relevance and effectiveness of the Directive's provisions.

Half of the Member States reported that the provisions of the Directive represent a tool that allows them to use excise duties to protect consumer health.
These authorities underlined the importance of having the flexibility to set excise duty rates, at the national level, that **exceeded the minimum rates** indicated in Directive 92/84/EEC, in order to enable them to take the protection of consumer health into account. However, other Member States noted that **consumer protection is not one of the purposes of the Directive**, and that the provisions were therefore neutral in relation to any health policy objective.

**Figure 43:** ***Overall, the provisions of the Directive 92/83/EEC allow for using excise duties on alcohol as a policy tool with regard to protection of consumer health***




*Source: Questionnaire to Member States August – November 2015*

The Member States' health authorities in particular agreed that **price was an important tool for influencing the consumption of alcoho**l, but their views differed on whether the Directive gives them possibilities in this regard. While some health authorities argued that higher prices on alcoholic beverages could lead to lower consumption and hence reduce the health damage caused by alcohol, others were concerned that the Directive does not recognise excise duties as being a policy tool, as well as the fact that it makes no mention that alcohol could be harmful and that the related societal costs could be responded to with appropriate taxation.

Overall, six Member States repeatedly referred to health policy as a reason for being dissatisfied with the current provisions or for opposing any changes to the Directive.

Comments received from consumers and associations of medical doctors and dentists in the context of the open public consultation show that these **stakeholders clearly expect the Directive to respond to the health risks** connected with the consumption of alcohol. These stakeholders suggested that excise duties should be imposed as a response to the negative externalities associated with alcohol consumption, and that the Directive should therefore encourage the production of alcohol having low alcoholic strength, and should lead to a general reduction in the consumption of alcoholic beverages by increasing their price. These stakeholders emphasised the role of the pricing of alcohol in having a significant impact on consumption patterns, especially among young people. One of the medical associations referred to a WHO report on alcohol consumption, its related harms, and some possible policy approaches that highlighted the importance of taxation as a tool for influencing consumption[109]. These organisations and consumers called on policy makers to ensure that the Directive supports the objective of reducing alcohol-related harm, and to avoid economic interests prevailing over their public health objectives.

## 8.3 Classification

Overall, the Member States considered that the definitions and classifications of the alcoholic products in the Directive were responsive to their needs. Where concerns were expressed, these related primarily to issues involving the classification of products, as Section 2 explains; they did not relate to concerns connected with public health.

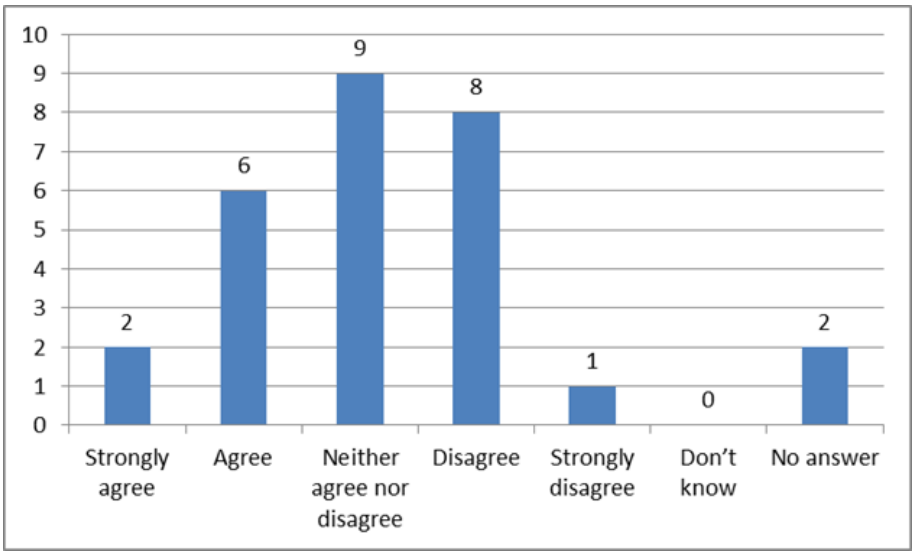
However, several Member States and respondents to the public consultation indicated that in order to achieve their health policy objectives, it would be beneficial to **consistently apply excise duty on the basis of alcoholic strength** instead of product volumes, and they also commented that differentiating between product categories would be unnecessary if this approach was taken.

The eight Member States[110] which noted that the calculation of excise duty on the basis of the alcohol content of the product conflicted with the health policy of their own country argued that calculating excise duty on the basis of alcoholic strength would **give consumers a clearer incentive to consume lower-strength products**. It would also allow the Member States to tax equally different alcoholic beverages having the same alcoholic strength. It was argued that such taxation would eliminate some of the current inconsistencies and classification issues.

[109] World Health Organisation (2012): Alcohol in the European Union; Consumption, harm and policy approaches. Available at: http://amphoraproject.net/w2box/data/AMPHORA%20Reports/Alcohol-in-the-European-Union-2012.pdf

[110] EE, FI, IE, MT, PL, SE, SI, UK

**Figure 44:** ***The calculation of excise duty based on the volume of the product rather than the actual alcoholic content conflicts with the health policy of my country***




*Source: Survey to Member States*

Member States which neither agreed nor disagreed that there was a conflict between their health policy objectives and the provisions of the Directive noted that the excise policy of their country with regard to alcohol and alcoholic beverages was not directly linked to its health policy objectives. One Member State stated that its consumer health policy could be achieved equally well whichever method of calculating excise duty on alcohol was used (i.e. drawing distinctions between various categories of alcoholic beverages versus the taxation of all alcohol on the basis of alcoholic strength).

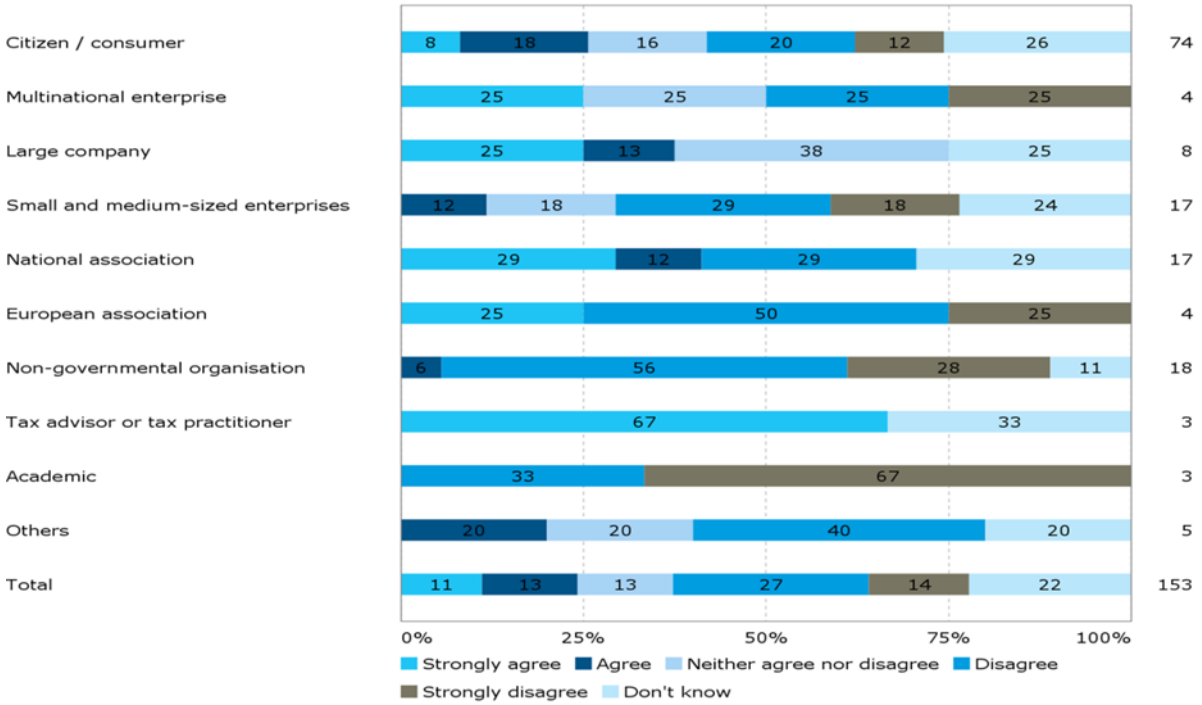
The Member States which saw no conflict between the calculation of excise duties and health policy either emphasised that they did not think excise duty should cater to the needs of health policy, or they stated that it was sufficient for the excise duties on some products to be calculated on the basis of their alcoholic strength.

The health authorities of six Member States[111] provided additional input regarding this issue. All of them argued that alcohol excise duty should be charged according to alcoholic strength by volume, because price was identified as being an important factor in encouraging healthy drinking behaviour. In their view, such taxation would eliminate some of the current loopholes. However, it was noted that the tax increase must also be passed on to the consumer in order for this measure to be effective.

The respondents who took part in the public consultation indicated an overall preference for taxation by alcoholic strength. As Figure 45 below shows, 41% of the respondents (strongly) disagreed that the excise duty calculation was reflecting health policy objectives. A majority argued that for health policy purposes, it would be beneficial to tax alcohol and alcoholic beverages on their alcoholic strength rather than their volume.

[111] DE, FR, IE, HU, PL, PT

**Figure 45:** ***Do you agree that the calculation of excise duty based on the volume of the product rather than the actual alcoholic content is in line with the health policy in your country? (N=153)***




*Source: Open public consultation, August-November 2015*

In particular, academics and associations of medical doctors and dentists have indicated that the provisions of the Directive were not responding to the Member States' health policies, while companies and their associations were less concerned about this issue. The associations noted, in the context of the public consultation, that linking price to alcoholic strength could discourage the consumption of higher-strength products. They described the current system as containing anomalies in the way different products are taxed, and commented that its **incentives for the production and purchase of lower-strength alcohol are insufficient**. In particular, for wine and cider, which attracts a zero-rate excise duty in several Member States, the current system has contributed to the increased availability of low-price, high-strength products.

When considering the **potential consequences** of introducing taxation according to alcoholic strength, it should be noted that the manner by which this could best be implemented is **unclear**. The Member States' tax authorities might be unwilling to increase current rates for beer or wine, which would mean that the duty rates for spirits could end up being adjusted downwards in order to decrease the relative difference in rates. One Member State even argued in favour of taxation by alcoholic strength, noting that excise rates for some products could be decreased.

## 8.4 Reduced rates, exemptions and other provisions

Apart from issues of classification and the discussion of the possible introduction of excise duty calculations using alcoholic strength as the basis, some Member States' tax authorities and respondents to the open public consultation mentioned health policy in connection with some of the other provisions of the Directive. Their considerations regarding reduced rates, exemptions and the calculation of excise duty on beer are presented below.

The stakeholders were not specifically asked their opinions about health policy while they were individually assessing each of the Directive's provisions[112]. The analysis below is based on a qualitative analysis of those responses that explicitly mentioned health policy. Consequently, the following section over-represents those respondents who included health policy in their immediate agendas.

Two types of reduced rate are allowed for by the Directive, which has led to opposing considerations regarding health policy objectives. While reduced rates for products of low alcoholic strength were generally viewed as being a way to achieve health policy objectives, the availability of reduced rates to small producers was somewhat criticised in this context.

Three Member States expressed their general support for **reduced rates for products of low alcoholic strength** for all types of alcoholic beverage. This support was based on health policy considerations. They argued that such reductions could promote alternative products containing less alcohol, and could encourage taxation based on excise duty that would be based on alcoholic strength.

One Member State stated its opposition to the **reduced rates for small spirits producers,** giving health policy as its reason. It stated that products of higher alcoholic strength were more damaging to consumer health, and their consumption should therefore not be incentivised over products having a lower alcoholic strength.

While respondents to the public consultation (strongly) agreed overall with the benefits of establishing common rules for applying reduced rates to small producers, the associations representing medical doctors and dentists disagreed. They argued that the impact of alcohol on health should be the primary consideration, and alcoholic beverages should therefore be consistently subject to high excise duties.

With regard to the effect on health policy of the exemptions, three issues were raised by the various stakeholders consulted: the exemptions for private production for own consumption; the potential introduction of exemptions for small producers; and the exemption of denatured alcohol, including the risk of its consumption.

Five Member States[113] perceived a health risk regarding the **exemption of private production** of ethyl alcohol. However, they did not go further and explain whether this risk was viewed as being the result of insufficient control over the production process for ensuring the quality of the alcohol produced, or whether their concern related instead to a potential increase in the alcohol consumption of these private producers.

With regard to the suggestion of **introducing exemptions for small producers**, three Member States brought up concerns about consumer health[114]. They explained that considering its negative impact on health, the taxation of alcohol should take the health and social costs caused by its consumption into account.

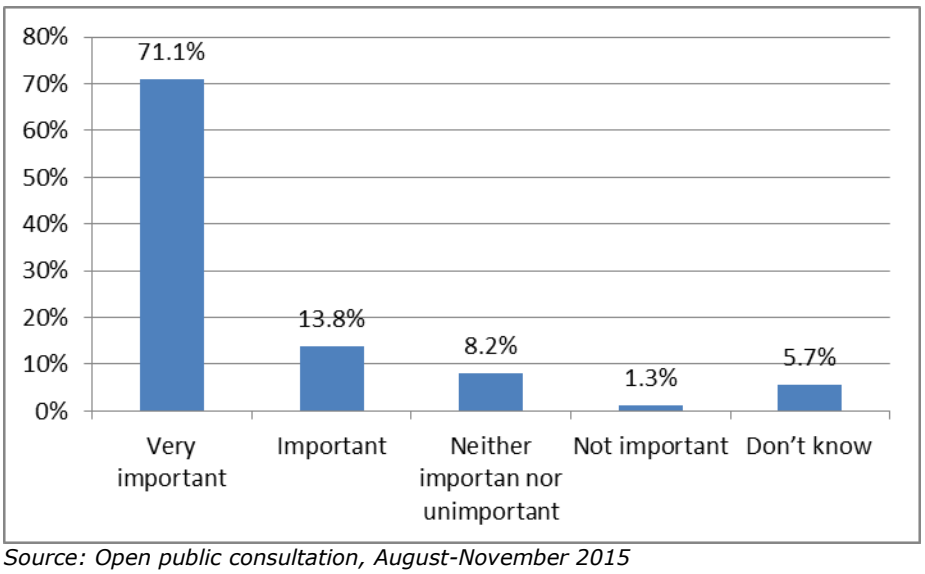
In the context of the **exemption of denatured alcohol**, consumer health considerations were mentioned, covering several aspects of the functioning of the provisions. Producers of products containing denatured alcohol indicated that they would always be seeking a denaturant which did not present a risk to the health of their consumers. They underlined their need for flexibility in being able to use a denaturant matching their product while simultaneously not presenting any health risk, depending on the intended use.

The Member State authorities underlined the health risks of fraudulently produced alcohol derived from denatured alcohol. The denaturants, as well as any other products added to the ethyl alcohol, could themselves represent a significant risk.

[112] See the annexes for a full list of the questions posed to the stakeholders in the context of the surveys, as well as their exact wording.
[113] CZ, EE, IE, MT, SK
[114] IE, MT, SK

In the public consultation, the awareness of consumers of these risks was tested. Over 90% of the citizens responding to the open public consultation reported being **aware that there are potentially serious health risks from consuming some types of illicit alcohol**. For 71% of all the respondents, it was very important to know that the alcohol they are drinking is both legitimate and safe to consume[115]. They stated that protecting their health was their main reason for choosing legitimate alcohol.

**Figure 46: *How important it is for you to know that the alcohol you are drinking is both legitimate and safe to drink?* (N=159)**




*Source: Open public consultation, August-November 2015*

With regard to the discussion about the **taxation of beer** based on the Plato method versus alcoholic strength, two Member States (DK, UK) argued that using the latter method was more consistent with health policy objectives, as the externalities in relation to beer are related to the consumption of alcohol, not to its Plato value. Calculating excise duty on beer on the basis of alcoholic strength would create price incentives to produce lower-strength beers.

[115] Those indicating "neither important nor unimportant" reported to be NGOs or "others".

# 9. Overall conclusions

This chapter presents the overall conclusions that can be drawn from the research conducted in the context of this evaluation.

To facilitate the evaluation of the Directive in accordance with EU Better Regulation guidelines[116] this section presents our overall conclusions against the main evaluation questions that match the evaluation criteria, as presented in Table 29. Question 7 regarding the recommendations is answered in Chapter 10.

**Table 29: Overview of evaluation questions and evaluation criteria**

| EQ No. | Evaluation Question | Evaluation Criteria/ Perspective |
|---|---|---|
| 1 | To what extent do the provisions of Directive 92/83/EEC ensure the proper functioning of the internal market? | Effectiveness |
| 2 | To what extent do the provisions of Directive 92/83/EEC safeguard the budgetary interests of the Member States? | Effectiveness |
| 3 | To what extent is there scope for compliance cost and administrative burden reduction? | Efficiency |
| 4 | What are the added benefits for the stakeholders of achieving the Directive's objectives at the EU level? | EU added value |
| 5 | To what extent do the provisions of Directive 92/83/EEC respond to the needs of the Member States and economic operators? | Relevance |
| 6 | To what extent are the provisions of Directive 92/83/EEC coherent with EU and international legislation on excise duties on alcohol and alcoholic beverages? | Coherence |
| 7 | Which of the problems identified could be solved through additional EU or national action and thus deserve further consideration? | Recommendations |

## 9.1 To what extent do the provisions of Directive 92/83/EEC ensure the proper functioning of the internal market?

In the context of this evaluation, the proper functioning of the internal market is understood to include three core components. The legislation should:

i) provide a clear and consistent framework for excise duties to be paid on alcohol and alcoholic beverages
ii) ensure a "level playing field" in terms of competition between economic operators
iii) limit the risk of circumvention of excise duty.

Overall, the Directive was found to be effective in achieving these three objectives. Through the harmonisation of structures, the approximation of rates[117] and the definition of the scope of application of excise duty, **at a general level**, **the Directive allows intra-community trade to take place** free of significant tax-related trade barriers, or major competitive disruptions between economic operators operating in the same sector of activity.

[116] Better Regulation Guidelines, SWD(2015) 111 final, Strasbourg, 19.5.2015, Available at: http://ec.europa.eu/smart-regulation/guidelines/toc_guide_en.htm
[117] We refer to this as we consider that the effects of the quantitative and qualitative limits set for reduced rates are similar to those aiming to approximate national excise duty rates.

The Directive successfully structures the taxation of alcoholic beverages in the categories specified in Directive 92/84/EEC by setting minimum excise rates. There are clear rules with regard to the possibility of setting reduced rates for small producers or low-strength alcohol products. This provides a consistent framework for the taxation of alcohol.

Despite this overall positive conclusion, there are several points where the Directive does not provide the necessary legal clarity, and the issues this creates have an adverse effect on the functioning of the internal market.

The classification of certain products remains unclear because they could fall into any one of several categories, resulting in different treatment in different Member States and complications when these products have to be transported. Similarly, the difficulties encountered with the interpretation of the provisions for exempting denatured alcohol hinder the proper functioning of the internal market, as the conditions for such exemption vary considerably across the Member States.

Where the Directive does sets clear rules, it also ensures similar conditions for economic operators across the EU. Their products are taxed on the basis of principles that apply in all the Member States. However, the absence of clarity regarding the exemptions for denatured alcohol permits excessive room for interpretation by the Member States. In turn, this leads to **strong imbalances in competition**, because the producers and users of denatured alcohol located in some Member States have a much wider choice of denaturants than those in other Member States.

Furthermore, the Member States are **unable to consistently apply reduced rates to small producers** in respect of all the categories of alcoholic beverage. This unnecessarily limits the ability of the Member States to correct potential market imbalances where such a policy objective might be worth pursuing.

The effectiveness of the Directive concerning its ability to limit the risk of excise duty being circumvented is discussed in the following section, which focuses on the extent to which the Member States are able to safeguard their budgetary interests.

## 9.2 To what extent do the provisions of Directive 92/83/EEC safeguard the budgetary interests of the Member States?

The second crucial intentional effect of the Directive is to ensure that the Member States' authorities are able to collect excise duty effectively. Concerning the potential loss of excise duties for Member States, this study considered:

i) fraud involving alcohol and alcoholic beverages, and specifically the extent to which fraud involving denatured alcohol is taking place;
ii) the potential misclassification of alcoholic beverages into a tax category lower than was intended by the Member States.

The Directive's provisions for ensuring the denaturation of alcohol intended for industrial purposes aim to protect the integrity of the exemption, and prevent such alcohol from being converted back into consumable alcohol. Overall, the available data on fraud showed that **misuse of the exemption for denatured alcohol** represents a very low proportion of total alcohol-related fraud. However, in a few Member States the findings suggest that fraud with denatured alcohol is non-trivial. Further investigation would be needed to identify whether this fraud can be traced back to a deficiency in the Directive and to define denatured alcohol, how it is manufactured and used in order to qualify for the exemption, and require economic operators to use denaturing formulations which cannot easily and cheaply be removed from the product.

Several different product types were identified whose classification is not straightforward, and which could arguably be assigned to two or more different tax categories. Some of these products have been regarded as attempts to **abuse a favourable tax category**.

Besides creating competitive distortions, the failure to provide unambiguous classificatory definitions may result in the Member States losing revenue.

## 9.3 To what extent is there scope for reducing the cost of compliance and administrative burdens?

Directive 92/83/EEC does **not directly impose compliance costs** on economic operators. By including certain products in the scope of excise duty, it indirectly subjects those sectors to the provisions of Directive 2008/118/EC, which sets out the rules and conditions for holding and moving excise duty goods.

In relation to the indirect costs associated with these goods being subject to excise duty legislation, the evaluation of Directive 2008/118/EC has revealed that duty-suspended[118] arrangements are clearly cost-effective, and are proportional to their intended aims. Additionally, certain areas for improvement in relation to the cost-effectiveness of the duty-paid arrangements[119], in particular to those affecting alcoholic products, have been identified, and have been the subject of a number of recommendations currently being considered by the European Commission.

The administrative burden on stakeholders who find themselves subject to Directive 2008/118/EU because they fall under Directive 92/83/EEC is low or in the process of being reduced further. One might therefore argue that the application of the provisions of Directive 92/83/EEC is generally efficient.

However, since this evaluation has identified multiple areas in which the application of the provisions of the Directive is resulting in increased costs for both economic operators and Member States, **it cannot be concluded that the Directive is efficient**.

The increased administrative and compliance costs identified result not from the application of systematic obligations inscribed in legislation; rather, they are the result of the **complications, disputes and the inconsistent application** of the Directive's provisions that arise from situations in which stakeholders disagree on their correct interpretation. The number of examples supporting this assessment, plus their geographical extent, indicates that these complications are the result of a failure of the Directive to provide sufficient clarity to the stakeholders.

In particular, issues surrounding the classification of products which have been identified as 'difficult to classify' and the management of exemptions for denatured alcohol is resulting in increased costs for all the stakeholders concerned (including the Member States' tax authorities as well as the economic operators).

## 9.4 What are the added benefits for the stakeholders of achieving the Directive's objectives at the EU level?

The evaluation has assessed the added value of establishing common rules at the EU level for the classification of alcoholic beverages, the granting of reduced rates for small producers, and the exemption of denatured alcohol from the scope of excise duty.

The findings of this study clearly show that **only an EU-wide system can provide the uniformity and harmonised conditions** that are necessary to ensure the proper functioning of the internal market. It would not have been possible to achieve the same results in terms of effectiveness and efficiency – let alone more positive ones – via an alternative, bilateral or international approach.

Moreover, the stakeholders' divergent interpretations of the Directive show that its **effectiveness could be improved by expanding the EU-level approach**. Greater

[118] See: Evaluation of current arrangements for the holding and moving of excise goods under excise duty suspension, by Ramboll Management and Europe Economics: http://bookshop.europa.eu/en/evaluation-of-current-arrangements-for-the-holding-and-moving-of-excise-goods-under-excise-duty-suspension-pbKP0215865/
[119] Ibid.

engagement by the Commission in the future could be the response that would sustain and enhance the uniform application of the Directive's provisions across the EU.

Overall, the evidence collected shows that **all types of stakeholder strongly support an EU-level approach** regarding the excise duty levied on alcohol and alcoholic beverages. The stakeholders consulted pointed out that the provisions laid down at the EU level support the harmonised treatment which, they believe, in turn facilitates trade, prevents competitive distortions, reduces administrative costs and prevents fraud.

## 9.5 To what extent do the provisions of Directive 92/83/EEC respond to the needs of the Member States and economic operators?

This question sought to understand whether the provisions of the Directive as formulated are still fulfilling the needs of Member States and economic operators. As a result, it was assessed:

(i) whether the needs that the Directive sought to address still exist;
(ii) to what extent those needs have evolved, and how;
(iii) whether the arrangements meet the current needs.

While important progress has been made in the past twenty years towards the establishment of the common market, the Directive's objectives of providing a clear and consistent legal framework, ensuring fair competition and reducing the risk of excise duty being circumvented continue to be highly relevant. In this context, the provision of common rules regarding the levying of excise duty on alcohol and alcoholic beverages has continued to be important.

Consideration was given to whether the objectives of the Member States have evolved in relation to the imposition of excise duty on alcohol, insofar as they might today also include the **objective of influencing alcohol consumption habits** via adjustments in excise duty rates. In practice, only a few Member States mentioned any health policy objectives in connection with the overall relevance of the provisions; accordingly, no definitive conclusions can be drawn in this area.

Overall, the **specific provisions of the Directive were reported to correspond to the needs of the stakeholders**. The assigning of alcohol and alcoholic beverages to different categories for excise duty purposes continues to be relevant. Although some Member States (and spirits producers in particular) argued in favour of taxation based on alcohol strength but without specific product categories, the evidence shows that the maintenance of different categories is important for preserving socio-cultural traditions (e.g. the continuous production and consumption of traditional products often made from natural ingredients grown in a particular location), and for supporting the creation or preservation of jobs, practices and traditional crafts.

Our findings reveal that there are a **few provisions that no longer seem to be needed**, such as Article 28 regarding rules specifically for the United Kingdom which that Member State no longer applies. In addition, as several Member States have introduced positive excise duties on wine, the omission of reduced rates for small producers of wine and other fermented beverages can no longer be justified.

Finally, the relevance of reduced rates for products of low alcoholic strength was questioned. It can be assumed that these reduced rates correspond to national practices linked to health policy objectives, but they do not correspond to any of the overall objectives that are stated in the Directive and identified in the intervention logic. Specifically, reduced rates for intermediate products and ethyl alcohol are rarely used by the Member States, and they might actually be undermining the objectives of the provision in the first place, as they could unintentionally increase the consumption of a product benefiting from the reduced rate in its own duty category despite its alcohol

strength actually being higher than that of a similar product belonging to a different duty category.

## 9.6 To what extent are the provisions of Directive 92/83/EEC coherent with EU and international legislation on excise duties on alcohol and alcoholic beverages?

The evaluation has assessed the external coherence of the Directive with EU legislation and international agreements. Because the Directive was adopted more than 20 years ago, some changes have been made to ancillary legislation. However, these **changes are not damaging the coherence** of the provisions. While there are a number of references in the Directive to other EU legislation and to CN codes that need to be updated, the inconsistencies identified were not reported to be causing any significant practical problems.

Two points with regard to coherence are creating problems for economic operators, namely the **CN codes for denatured alcohol**, and the **treatment of wine precursors**. The Member States are not using the CN codes for denatured alcohol in a consistent manner. While there is a CN code for denatured alcohol (2207 20), a number of other codes are being used for particular products that may contain denatured alcohol. This can have an impact on the conditions applying to the movement of these products, as well on the ability of the Member States to monitor and control the movements.

Two Member States reported issues with the treatment of wine precursors (i.e. must and juices that are due to be turned into wine). The Directive does not define them as excisable goods, but they have to be moved under the EMCS.

In addition, no major factors which might reduce the internal coherence of the various different Articles of the Directive have been identified.

No inconsistencies between the Directive and international agreements were found.

# 10. Recommendations

This section presents the list of recommendations stemming directly from the findings of this evaluation.

In order to provide clarity and transparency, each recommendation is associated with a clear indication with respect to:

- The content of the action proposed
- The responsible stakeholder to which it is addressed
- The main arguments justifying its consideration
- The high level impacts expected (both intended and unintended)[120].

The recommendations follow the structure of the report, first covering classification, then reduced rates, the exemption of denatured alcohol and finally additional recommendations on further issues. Section 10.7 presents provisions for which we recommend maintaining the status quo.

## 10.1 Recommendations on the classification of alcohol and alcoholic beverages

**Table 30: Recommendation 1: Clarifying the excise category of other fermented beverages**

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Clarify the scope of application of the excise category of "other fermented beverages":** The definition of the excise category "other fermented beverages" should be clarified by the legislator in order to define unequivocally, for all relevant stakeholders, the intended scope of application of this category. While this recommendation does not imply that Directive 92/83/EEC should abandon the links between the definition of excisable alcohol products and the CN Codes, it does suggest that, at least for the category of "other fermented beverages" a more precise (tailored) qualification of the definition for excise purposes should be done which does not fully rely on the CN classification for determining adequate excise classification[121]. | **Member States, European Commission, European Council and European Parliament** |
| **Justification:** The existence of tax incentives that result from having one's product classified under one excise category rather than another has resulted in the development and marketing of products which seek to comply with the requirements of a more beneficial tax category[122] while arguably (i.e. in the opinion of the Member States' tax administrations and some competitors) circumventing the intention of the legislator regarding which products should fall into the more favourable category.<br><br>The issue of classification of these types of products is a material one, with hundreds of millions of Euros of potential tax revenue at stake each year. Disputes relating to the classification of particular alcoholic beverages show that the intention of the legislator is not being interpreted coherently across the EU, with potential consequences in terms of excise revenue, legal clarity and consistency of taxation across Member States, as well as on fair competition for economic operators.<br><br>Attempts to resolve the lack of clarity regarding what constitutes an "other fermented beverage" for excise purposes within the current legislative context which have focused on the legal interpretation of CN code 2206 have failed to provide an acceptable, coherent and unequivocal resolution to the issues reported; and despite landmark ECJ cases regarding this issue, they are not expected to comprehensively do so in the future.<br><br>Because we do not expect (nor do we recommend) that a fundamental change to the structures for setting excise duty on alcohol products which would eliminate the current excise categories and link excise duty to alcohol content could feasibly be implemented and achieve satisfying outcomes for all the stakeholders concerned, a solution within the current framework (which differentiates between different categories of alcoholic beverages) needs to be sought.<br><br>Table 8 (see Section 2.7) has presented a wide range of different potential solutions that would attempt to | |

[120] It should be emphasised that, as a detailed analysis of the impacts of any specific changes to the Directive has been out of scope of this (mainly) retrospective evaluation, the elements presented in this section do not prejudice in any way the systematic and in-depth impact assessment to be conducted in preparation of any legislative changes ultimately considered.
[121] This approach is followed in the case of tobacco taxation with satisfying (albeit not perfect) results.
[122] See the decision of the England and Wales High Court in the case of *Diageo North America, Inc. & Anor v. Intercontinental Brands*; etc.

| Recommendation | Responsible stakeholder(s) |
|---|---|
| resolve the classification issues identified. While these provide several insights regarding how the final recommendation presented here can be defined in practice, each one is associated with a number of negative outcomes and risks, reducing their feasibility as suitable stand-alone recommendations. | |
| **Expected impact:** because clarifying the intended scope of the category "other fermented beverages" can be achieved through a broad range of potential options, it is not possible to estimate accurately the expected impact of its implementation.<br>Nevertheless, the justification for implementing such a recommendation should determine the development and assessment of options. For this purpose, we reiterate that this recommendation should be implemented in order to ensure that products which in the opinion of the legislator (i.e. in this case, the Member States, collectively through the action of the European Council and the European Parliament) abuse the beneficial tax treatment conferred by the existence of the excise category of "other fermented beverages" are given treatment that corresponds to their characteristics, AND that the same (or characteristically similar) products will be assigned, for excise purposes, to the same tax category across the EU.<br><br>As a result, any in-depth impact assessment of proposed changes should pay special attention when considering the expected impacts regarding at least the following aspects:<br>• A careful analysis of what products are expected to change their excise classification as a result of the revision implemented (in order to identify and avoid potential unintended effects)<br>• The expected change in excise revenue for the Member States (which may increase or decrease, depending on whether the scope of the category is enlarged or restricted)<br>• The competitive effects on products expected to be classified differently as a result of any revisions, and in particular, an analysis of whether such a change would unduly affect products which directly compete with those that are not expected to change their classification as a result of the revision. | |
| **Type: Legislative**<br>The implementation of this recommendation requires legislative changes to Directive 92/83/EC.<br>In contrast with other possible solutions considered, a redefinition of the category of "*other fermented beverages*" will not require changes to be made to Directive 92/84/EEC regarding the approximation of rates, as the reference made in the latter act to Directive 92/83/EEC will remain unchanged. This is important in the context of the fact that past attempts to revise Directive 92/84/EEC have not achieved the required unanimity within the Council. | |
| **Priority: Very High**<br>As a result of the widespread nature of the problems reported, as well as their consequences in terms of costs and potential revenue impact, this recommendation should be pursued in priority. | |

## Table 31: Recommendation 2: Modifying the technical specifications of the EMCS

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Create another excise category code within the EMCS:** Annex II, Table 11 (Excise Product) of Regulation 684/2009 should be amended to include two additional Excise Product Codes (EPC): one for still fermented beverages other than wine and beer, and another for sparkling fermented beverages other than wine and beer. | **European Commission**<br>**Member States** |
| **Justification:** Currently, "wine" and "other fermented beverages" share the same EPC. Where potential differences in national excise rates between the two categories result in different excise burdens, risks and associated guarantees in intra-community movements, the EMCS should distinguish between the two excise categories | |
| **Expected impact:** The intended impact of this recommendation will be that the EMCS will accurately differentiate the movements of "other fermented beverages" from those of wine. As a result, the establishment of guarantees will be more accurate, as will the ability of the Member States to conduct accurate statistics and risk analysis.<br>This recommendation entails a non-negligible element of compliance costs for the Member States: Upgrading and updating the national systems of the EMCS will be necessary in order to bring the systems in line with the revised technical specifications. The change, although technically simple, will likely entail non-trivial costs and efforts on the part of the Member States. | |
| **Type: Legislative**<br>The implementation of this recommendation requires changes to Annex II, Table 11 (Excise Product) of Regulation 684/2009 | |
| **Priority: Medium**<br>As there are no major, immediate and urgent negative consequences stemming from the current specifications, this recommendation may be implemented alongside other scheduled changes to the EMCS, thus minimising the marginal costs of the upgrade. | |

**Table 32: Recommendation 3: Clarifying the notion of "*entirely of fermented origin*"**

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Clarify the notion of "entirely of fermented origin" within the understanding of Articles 8, 12(1) and 17:** A potential revision of Directive 92/83/EEC should contain a clearer statement of the understanding of the concept of "entirely of fermented origin" to enable a meaning that will be accepted by all the Member States and subsequently enforced to ensure consistent treatment. Although this measure would best be implemented through a legislative amendment, which would maximise the level of harmonisation, in the absence of such a revision (or in the short term), it may also be implemented through soft-law measures, such as a Commission recommendation. | **Member States, the European Commission, European Council and European Parliament** |
| **Justification:** Different interpretations of the meaning of "entirely of fermented origin" relate to the treatment of the same product in different Member States, and can therefore adversely affect the functioning of the internal market when the Member States have different interpretations of what constitutes a product of entirely of fermented origin.<br>As an example, our research has shown that in some Member States, the addition of flavours with alcoholic content to a wine base product is possible without losing the W200 excise classification. However, national legislation is not harmonised in this respect, leading to situations where the same product is classified as an intermediate product in some Member States and as a fermented beverage in others, with adverse impacts on the internal market and the stability of taxation across the EU. | |
| **Expected impact:** The main impact of this recommendation will be to ensure a coherent application of excise legislation and a consistent treatment, for excise purposes, of similar products across different Member States. | |
| **Type: Legislative**<br>On the short term, this recommendation may be implemented through soft law measures, however, to ensure uniform application, on the long term, the implementation of this recommendation requires changes to Directive 92/83/EC | |
| **Priority: Medium**<br>The problems justifying the implementation of this recommendation are fewer in number and lead to less severe consequences than those justifying the implementation of recommendation No.1 (see above), nevertheless actions for alleviating them should be taken as part of the effort to ensure an adequate functioning of the internal market in this area. | |

## 10.2 Recommendation on reduced rates for small producers

**Table 33: Recommendation 4: Extending the scope of reduced rates for small producers**

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Consider extending the application of reduced rates to small producers of still and sparkling wines, other fermented beverages and intermediate products:** While this evaluation makes no judgement on any potential qualitative and quantitative limits to be introduced, a potential revision of Directive 92/83/EEC should consider the inclusion of the possibility (i.e. a formulation as *"Member States may"*) for the Member States to introduce rates specifically for small producers of alcoholic beverages in all excise product categories. | **Member States, the European Commission, European Council and European Parliament** |
| **Justification:** A number of Member States would like to have the option of introducing reduced rates for small producers within certain product categories which are currently not covered by the provisions on reduced rates for small producers inscribed in the Directive.<br><br>Based on our competition analysis, it seems unlikely that the presence of reduced rates for small brewers and small distilleries has caused any negative competitive distortions within their markets (nor in the markets of other product categories). To the extent that the rationale for the introduction of reduced rates holds for small brewers and distillers (i.e. to level the playing field and allow small producers of these products to compete more effectively against larger producers), it may be appropriate to extend this rationale to producers of other beverages too, as economies of scale are also likely to exist in those sectors. | |

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Expected impact:** The impact of this recommendation will be to bring the treatment applied to small (the concept of "small" remains to be determined individually for each category) producers of wine, other fermented beverages, and intermediate products, in line with the treatment given to small breweries and distilleries. As is currently the case for beer and ethyl alcohol, the Member States would be able to decide, on the basis of national policy decisions, whether to implement this reduced-rate option for small producers connected with any of the product categories.<br>As a result, while the decision regarding whether or not to introduce such rates at a national level would become a national policy decision, on the basis of the evidence presented in this report it is clear that such a move would be unlikely to induce any negative competitive distortions, either within national markets or in respect of intra-community trade.<br>The implementation of this recommendation would give Member States more flexibility to design country specific excise regimes in line with national needs and priorities, while the qualitative and quantitative limits which would apply would aim to ensure that such flexibility continues not to unduly impact the proper functioning of the internal market, | |
| **Type: Legislative**<br>The implementation of this recommendation requires legislative changes to Directive 92/83/EC | |
| **Priority: Medium**<br>While the improved flexibility of MS in setting reduced rates for all product categories would be welcome, it is not seen as urgent. | |

## 10.3 Recommendation on reduced rates for low-strength alcohol

### Table 34: Recommendation 5: Further investigate reduced rates for low-strength alcoholic beverages

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Further investigate the extent to which provisions on reduced rates for low-strength alcohol can support restated policy objectives:** The European Commission should investigate in-depth the extent to which the provisions for reduced rates can be used to pursue re-established, clear policy objectives (e.g. the reduction of alcohol-related harms). This process should be taken up in dialogue with the Member States' tax and health authorities.<br><br>In our view, such an assessment should take into account at least the following elements:<br><br>• What threshold is most appropriate in the light of the policy objectives which are to be pursued?<br>• What level of harmonisation is necessary to ensure the proper functioning of the internal market and to avoid unintended, negative competitive distortions?<br>• How can internal coherence between the different provisions for each product category be ensured, particularly in the context of cross-substitution and the potential for abuse? | **European Commission, Member States** |
| **Justification:** It is our assessment of the objective behind the existence of these provisions is not fully understood by all stakeholders involved. In particular, the extent to which these provisions should favour the consumption of low-strength alcohol in pursuit of health objectives may come into conflict (both in terms of application, as well as in terms of understanding of the provisions) with the objective of ensuring equal fiscal treatment.<br><br>The lack of a clear rationale for providing Member States with the possibility to apply reduced rates for low strength alcoholic products may negatively influence the use of these provisions. The stated purpose of the Directive that sets common upper limits at the EU level below which reduced rates can be introduced by Member States is to protect internal market objectives. However, at the level of their implementation (i.e. at the level at which they are adopted and put into practice by Member States), the introduction of reduced rates for alcoholic beverages below a certain alcoholic strength is intended to encourage the production and consumption of lower-strength beverages within each category. The Directive does not explicitly state that these provisions are to be seen as a tool for pursuing health policy objectives. This may negatively affect their uptake by Member States, the adequacy of their implementation nationally and the level of support they receive from the public and industry.<br><br>While the current provisions have been reported to be largely accepted as appropriate by stakeholders, this | |

| Recommendation | Responsible stakeholder(s) |
|---|---|
| evaluation has found several weaknesses in relation to each individual provision.<br>As the full extent of these weaknesses could not be analysed in the context of this evaluation (in the context of a lack of common understanding, by stakeholders, of the core policy purpose of these provisions), further investigation is recommended. Such an in-depth analysis could be performed in the context of a future impact assessment to investigate the impact of several policy options against restated policy objectives. | |
| **Expected impact:** In the context of a potential revision of Directive 92/83/EEC, additional information and an assessment of the provisions against clear, re-established objectives (as well as in the light of new-found evidence of potential abuse of one of the excise categories) would allow the European Commission to develop suitable proposals for ensuring that the provisions on reduced rates for low-strength alcoholic beverages are fit for purpose. Furthermore, it would allow the Member States to ensure that the provisions of the Directive correspond to their needs in terms of their health policy objectives. | |
| **Type: Additional research**<br>The implementation of this recommendation requires additional research of the reported problems. Ultimately, however, it is expected that **legislative changes** to Directive 92/83/EEC will be required to fully implement the recommendation. | |
| **Priority: High**<br>Provisions on the application of reduced rates for low-strength alcohol are an important element of the Directive, their proper functioning is essential to ensuring a coherent application of the Directive. | |

## 10.4 Recommendation on reduced rates and exemptions for own consumption

### Table 35: Recommendation 6: Further investigate exemptions for private production for own consumption

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Investigate the impacts of allowing the Member States to exempt the production of ethyl alcohol and intermediate products for own consumption**: The European Commission should consider analysing the likely effects of expanding the exemptions for beer, wine and other fermented beverages stemming from private production intended for own consumption (Articles 6, 10 and 14 respectively) to cover intermediate products and ethyl alcohol. This in-depth investigation should look not only at possible positive impacts, but also consider carefully the risks implied by such a proposal, not least in relation to the potential for fraud and abuse. Regarding the latter, the experience of Member States which currently apply a reduced rate for ethyl alcohol produced by fruit growers for their own consumption, and in particular the effectiveness of their national measures to prevent fraud and abuse, can be adequate indicators for assessing risks. | **European Commission** |
| **Justification:** Most Member States apply the current exemptions on beer, wine and fermented beverages, and have not reported any severely negative experiences from applying these provisions. However, when it comes to the possibility of extending exemptions to cover intermediate products and ethyl alcohol, opinions are more divided, with most Member States having a strong view on whether such exemptions should be allowed.<br><br>Countries which are in favour of extending the exemptions do so either because of the important role that traditional home-made spirits and production methods play in their country's culture, or because they believe that such exemptions would legalise alcohol production which would otherwise take place illegally. For countries which are against the expansion of exemptions, the main reasons are related to the perceived increased risk of (cross-border) fraud, higher administrative costs and burdens, and also perceived health risks. | |
| **Expected impact:** In the context of a potential revision of Directive 92/83/EEC, an in-depth analysis of the benefits, risks and, particularly, of the effectiveness of potential national measures which Member States could lay down for the purpose of preventing any possible evasion or abuse would allow the European Commission to develop suitable proposals for ensuring that the provisions on exemptions for private production for own consumption adequately satisfy the legitimate needs of all the Member States.<br><br>Similarly to the rationale behind recommendation 4 (see above) the implementation of this recommendation would give Member States more flexibility to design country specific excise regimes in line with national needs and priorities. Any potential limits (or conditions) which would apply would aim to ensure that such flexibility | |

| Recommendation | Responsible stakeholder(s) |
|---|---|
| does not unduly; negatively impact Member States which do not wish to implement such provisions nationally. | |
| **Type: Additional research**<br>The implementation of this recommendation requires additional investigation of the reported problems. Ultimately, however, if considered appropriate, **legislative changes** to Directive 92/83/EEC will be required. | |
| **Priority: Medium / Low**<br>There is no evidence to suggest that the implementation of this recommendation requires urgency (as there are no immediate, major negative consequences resulting from a delayed implementation). Moreover, as can be read in our section on maintaining the status quo (see section 10.7), we recommend that current derogations granted to some Member States (e.g. on fruit growers) should be maintained.<br>While maintaining the status quo may be appropriate on the short term, on the longer term, however we view the entrenched positions of some Member States in this topic as an argument for ensuring that this issue is taken up on the Commission's agenda and fully considered. | |

## 10.5 Recommendations on the management of exemptions for denatured alcohol

### Table 36: Recommendation 7: Revise the formulation of Eurodenaturant

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Continue efforts to revise the composition of the Eurodenaturant formulation:** The denaturing procedure employed in all Member States for complete denaturation as specified in Regulation 162/2013 are in the process of being reduced from 3 litres of IPA, 3 litres of MEK and 1 gram of denatonium benzoate per hectolitre to a formulation of 1 litre IPA, 1 litre MEK and 1 gram denatonium benzoate. These efforts are aligned with the removal of remaining existing national formulations. The findings of this evaluation are consistent with the current efforts undertaken by the Commission in this respect. | **European Commission and Member States** |
| **Justification:** Economic operators have reported significantly higher costs (both for ingredients and for storage costs) with the use of the Eurodenaturant compared to any of the national methods for complete denaturation. In addition, the high concentration of the denaturing agents in the alcohol can have an adverse impact on the quality of the final product. As a consequence, many users of denatured alcohol do not employ this method, putting Member States which have abolished their own national method at a disadvantage. | |
| **Expected impact:** Reducing the quantity of ingredients required will make the use of the Eurodenaturant more attractive. A number of economic operators have reported clear advantages from using a denaturing method that is recognised in all Member States. More widespread use of the Eurodenaturant could potentially even lead to a further harmonisation of denaturing methods as more Member States decide to stop using their own national method. Evidence suggests that a denaturant containing only 1 litre of IPA and 1 litre of MEK will ensure the same degree of protection against fraud. However, this should be confirmed through laboratory testing before changing the current formulation.<br>However, the full extent of the impacts on the functioning of the market for completely denatured alcohol (i.e. removal of distortions) is dependent on the reduction in the number of CDA formulations from the Annex of the Regulation | |
| **Type: Legislative**<br>The implementation of this recommendation requires legislative changes to Regulation 162/2013 | |
| **Priority: n/a**<br>Efforts are on-going. | |

### Table 37: Recommendation 8: Ensure a common interpretation of mutual recognition of denaturing methods

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Ensure a common interpretation of mutual recognition:** All Member States should apply the same interpretation regarding the conditions under which the denaturing methods listed in Regulation 162/2013 for complete denaturation can be used. | **European Commission, Member States** |
| **Justification:** Currently, the interpretation of the principle of mutual recognition of denaturing methods listed in Regulation 162/2013 varies greatly across the Member States. While some Member States recognise any of the listed methods for production in their own country, others limit national production to the own methods but allow producers from other Member States to use all of the methods, while a separate group of Member | |

| Recommendation | Responsible stakeholder(s) |
|---|---|
| States recognises completely denatured alcohol from other Member States only if it is denatured with the method of the country of production. This creates unfair competition, as some users of completely denatured alcohol have a much wider choice of denaturing methods. The provisions can also be used in a protectionist manner, incentivising users of completely denatured alcohol to purchase alcohol denatured with the allowed national formulation only from nationally established producers. In addition, uncertainty is created for economic operators, even to the point where they might make business decisions such as where to set up their production facilities, on the basis of favourable conditions generated by the uneven application of the legislation. | |
| **Expected impact:** In line with the general understanding of the principle of mutual recognition (not just in the area of taxation, but in all areas of the internal market) all the Member States should recognise all the methods listed in Regulation 162/2013 for complete denaturation nationally and for completely denatured alcohol coming from another Member State;<br>A consistent interpretation by all Member States would ensure more certainty for economic operators, allowing for a better functioning of the internal market. In addition, it the equal treatment of operators would eliminate any disruptions to fair competition. | |
| **Type: Legislative**<br>The suggested changes could be implemented either through a change in the Directive or by stricter enforcement from the Commission of their understanding of mutual recognition. As the latter could be disproportionately confrontational, giving clearer guidance by actually changing the wording of the Directive might be more appropriate. | |
| **Priority: Very High**<br>As a result of the widespread nature of the problems reported, as well as their consequences in terms of market disruptions, this recommendation should be pursued in priority. – However, if Commission efforts undertaken in the context of recommendation 7 (see above) are fully successful, the implementation of this recommendation will no longer be necessary. | |

## Table 38: Recommendation 9: Ensure a common understanding regarding which products can be exempted under Article 27.1 (b)

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Ensure a common understanding of which products can be exempted under Article 27.1 (b):** Article 27.1 (b) should be clarified in order to ensure a common understanding across all Member States of what constitutes alcohol exempt under Article 27.1 (b). The scope of the Article should be clarified in order to unambiguously specify what constitutes alcohol exempt under Article 27.1 (b) as compared to Completely Denatured Alcohol (Article 27.1 (a) ) as well as the point at which it can be considered to have become exempt alcohol. It should further clarify the consequences that flow from the distinction (e.g. in terms of the requirements for monitoring and control) between alcohol exempt under article 27.1 (a) and article 27.1 (b). | **European Commission, Member States** |
| **Justification:** Evidence shows that despite the opinion issued by the ITEG on the interpretation of the term "not for human consumption", not all of the Member States apply the same rules to products that qualify for exemption under Article 27.1 (b). The requirements for movements of products manufactured using denatured alcohol in bulk are still not consistent across the Member States.<br><br>Furthermore, as there is no common understanding of what constitutes a completely denatured alcohol among the MSs (see the recommendation above), nor whether a given national formulation under Article 27.1 (b) is considered sufficient for securing an exemption in cases of intra-community movements, economic operators are facing uncertainties.<br><br>At the same time, the economic operators underlined their need for flexibility in using different denaturing methods which can be adapted to their particular products. Therefore, linking denaturing methods under Article 27.1 (b) to specific uses does not seem to be a feasible or desirable approach. | |
| **Expected impact:** Setting down clearer rules for exemption under Article 27.1 (b) can increase certainty for economic operators. . While not significantly limiting the list of possible denaturation methods (which would remain to be defined by individual Member States, this solution provides more certainty for economic operators, and a more harmonised approach to the provisions across the Member States.<br>By contrast with a solution that foresees linking denaturants to uses, the implementation of this recommendation would not require research and investment to identify denaturing methods that would match all producers from a particular sector. To limit the potential for fraud, it should be stressed that up to the point at which it is considered to become exempt under a revised Article 27.1 (b), the alcohol should be stored, held and denatured in tax warehouses (as is currently the case), and that Member States could, wherever they considered a denaturing method to be linked to an abuse, request another Member State to withdraw this method (see Article 27.5 of the Directive). | |

| |
|---|
| **Type: Legislative**<br>The implementation of this recommendation requires revision to Directive 92/83/EC. |
| **Priority: High**<br>As a result of the potential consequences in terms of market disruptions caused by reported problems, this recommendation should be pursued in priority. |

## Table 39: Recommendation 10: Ensure a consistent approach towards denatured alcohol coming from outside the EU

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Ensure a consistent approach towards denatured alcohol:** With regard to the exemption of completely denatured alcohol from a third country, the Committee on Excise Duty noted in 2014 that "*in case of importation and clearance for free circulation it is the Member State of importation who has to monitor that the denaturing has been properly done in accordance with the rules of the Member State of importation. All other Member States are dependent on the decisions of the Member State of importation.*"[1] The Commission should ensure that Member States follow this understanding and request the use of the denaturing method of the country where the alcohol will be released into free circulation. | **European Commission, Member States** |
| **Justification:** The requirements applying to completely denatured alcohol coming from third countries into the EU differs across the Member States. Several authorities indicated that operators from third countries can use any of the denaturing methods listed in Implementing Regulation 162/2013 for complete denaturation, whereas national producers can only use the method listed by their country.<br>Such a treatment can create unfair competition for producers from the EU compared to those from outside the EU. Producers from third countries are advantaged over EU producers, as they can choose from among all the methods for complete denaturation. | |
| **Expected impact:** Creating a common approach ensures that denatured alcohol from these countries will be treated the same way in all Member States. Ideally, a system should be found that creates a level playing field for different producers and creates the same requirements for the importation of denatured alcohol into all the Member States.<br>One of the ways to achieve this would be to request the use of the denaturing method of the country where the alcohol will be released into free circulation. However, a level playing field can only be created where the recommendation in Table 38 is followed and a common application of mutual recognition of denaturing methods is ensured.<br>If a common interpretation of mutual recognition of completely denatured alcohol cannot be found, a different approach needs to be found which ensures that no EU producers are disadvantaged in their choice of denaturing methods versus non-EU producers. To better understand the needs of economic operators and the actual impact on competition of this inconsistent approach, further research should be undertaken. | |
| **Type: Legislative**<br>The suggested changes could be implemented either through a change in the Directive or by stricter enforcement from the Commission of their understanding of mutual recognition. As the latter could be disproportionately confrontational, giving clearer guidance by actually changing the wording of the Directive might be more appropriate. | |
| **Priority: High**<br>As a result of the potential consequences in terms of market disruptions caused by reported problems, this recommendation should be pursued in priority. | |

## Table 40: Recommendation 11: Implement measures aimed at increased mutual trust between the Member States

| Recommendation | Responsible stakeholder(s) |
|---|---|

[1] Committee on Excise Duty (2014): Interpretation and application of Commission Regulation (EU) No 162/2013 of 21 February amending the Annex to Regulation (EC) No 3199/93 (CED 846)

| | |
|---|---|
| **Implement measures aimed at increased mutual trust between Member States:** Member State authorities need to feel reassured that no fraudulent activities can take place when allowing the movement of denatured alcohol from another Member State to their territory. To this end, the level of trust between the countries needs to be increased. One step would be to create more transparency and awareness of what controls are implemented in other Member States. In practice, an analysis of control measures could be done either in the context of the work of the ITEG or, if deemed appropriate, in the context of a specific study funded by the Commission. | **European Commission, Member States** |
| **Justification:** The way in which the Member States interpret and apply the provisions for exempting denatured alcohol under Article 27.1 (a) and (b) seem to suggest a mutual lack of trust between the authorities. At least one Member State only recognises its own denaturing methods, explaining that other countries' formulations do not allow for sufficient protection against fraud. Moreover, many Member States apply exemptions in a way that makes it easier for producers and users to use their own country's denaturing methods rather than those of another country. As the data concerning actual instances of fraud shows, fraud involving denatured alcohol has not been reported to be a significant issue by most Member States. This suggests that their authorities do not trust other Member States to provide the same controls against fraud as they themselves would do nationally. As a consequence, obstacles are created for economic operators wishing to use denatured alcohol based on the formulations of other Member States. | |
| **Expected impact:** Once the Member States' authorities could feel reassured that other Member States will ensure effective levels of protection against fraud, they would be more inclined to implement a functioning mutual recognition regime (see recommendation 8). This would facilitate the trading of denatured alcohol within the EU, and an important step would have been taken towards achieving a level playing field for economic operators from all Member States. | |
| **Type: Non-legislative** | |
| **Priority: Medium / Low**<br>Measures to increase trust between Member States are seen as ancillary to other recommendations within this section. | |

### Table 41: Recommendation 12: Conduct further research into the volume and value of fraud stemming from the abuse of exemptions from denatured alcohol

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Conduct further research into the volume and value of fraud stemming from the abuse of exemptions for denatured alcohol:** The evidence on the magnitude of fraudulent use of denatured alcohol is limited. This is to be expected given the inherent uncertainty in measuring illicit activity. However, many Member States have been able to provide some estimates of the likely scale of the problem, suggesting that there is scope for some degree of measurement. The measurement of this type of fraud (e.g. through analysis of seizures) could be improved, and upon further investigation, it may be concluded that increased and/or standardised sharing of information across Member States is appropriate. It would also be relevant to understand whether this fraud can be somehow linked to the Directive or if there are lacking controls at national level. | **European Commission, Member States** |
| **Justification:** The evidence on alcohol fraud generally is by its nature uncertain. Therefore, measurement of fraud resulting from fraudulent use of denatured alcohol is much more difficult. However, some Member States were able to provide estimates of the magnitude of this type of fraud, and there is evidence from other sources on this type of fraud. Our analysis suggests that fraudulent use of denatured alcohol does occur and is non-trivial in certain Member States. Therefore, collection of better statistics could be justified to help understand whether additional policy action to prevent this type of fraud is warranted. | |
| **Expected impact:** Collection of better information on abuse of exemptions for denatured alcohol should help to verify our estimates of fraud and allow Member States to monitor whether the problem is growing and whether action should be taken to mitigate this type of illicit activity. | |
| **Type: Non-legislative** | |
| **Priority: Medium / Low**<br>Measures to improve data availability on fraud stemming from the abuse of exemptions from denatured alcohol are seen as ancillary to other recommendations within this section. | |

## 10.6 Other recommendations

## Table 42: Recommendation 13: Updating references in the Directive

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Update references in the Directive:** References in the Directive to outdated legislation and CN codes should be updated. | **European Commission and Member States** |
| **Justification:** As the Directive was adopted more than 20 years ago, some of the legislation and CN codes it refers to are outdated or no longer exist. A complete overview of references to EU legislation which has subsequently changed can be found in Table 28. The Directive uses the CN codes that were applicable in 1992 (see Article 26). The CN codes 2204 21 10 (Articles 8.2 and 12.2) and 2206 00 91 (Article 12.2) mentioned in the Directive are no longer present in the CN classification of today. | |
| **Expected impact:** Updating these references would ensure greater clarity and facilitate the readability of the Directive. It would also avoid any future legal uncertainties with regard to the provisions of the Directive. | |
| **Type: Legislative** | |
| **Priority: Medium / Low**<br>As there are no major, immediate and urgent negative consequences stemming from the reported inconsistencies, this recommendation should be implemented in the wider context of a potential revision of the Directive 92/83/EEC. | |

## Table 43: Recommendation 14: Ensure coherence of the definition of sparkling beverages with the definition employed for customs purposes

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Ensure coherence of the definition of sparkling beverages with the definition employed for customs purposes:** The definition of sparkling wine and other sparkling beverages with regard to the level of excess bar pressure should be aligned with the definition used for customs purposes. | **European Commission and Member States** |
| **Justification:** Article 8.2 defines sparkling wine to have "an excess pressure due to carbon dioxide in solution of three bar or more". Among other CN codes, the definition refers to the outdated 2204 21 10 and also 2204 29 10. However, in the CN codes dating from 1992, products falling under these two codes are defined as having "an excess pressure due to carbon dioxide in solution of not less than 1 bar but less than 3 bar". The same CN codes are also used in Article 12.2 to describe other sparkling fermented beverages which are similarly defined in the Article as having an excess pressure of at least 3 bar. Such incoherence in definitions has the potential to create uncertainty regarding how to classify a sparkling fermented beverage or sparkling wine with an excess pressure below 3 bar.<br><br>Furthermore, in the additional notes to CN codes of 1992, products specified by CN 2206 00 91 are described as having an excess pressure of not less than 1.5 bar. This code is also used in Article 12.2 to describe other sparkling fermented beverages. Again, there is a discrepancy concerning the minimum excess pressure required to be able to define a beverage as sparkling. | |
| **Expected impact:** Aligning the definition used for excise purposes with the definition used for customs purposes would improve the coherence between the two systems. It would also avoid future uncertainty as to how beverages with an excess pressure below 3 bar should be treated. | |
| **Type: Legislative** | |
| **Priority: Medium / Low**<br>As there are no major, immediate and urgent negative consequences stemming from the reported inconsistency, this recommendation should be implemented in the wider context of a potential revision of the Directive 92/83/EEC. | |

## Table 44: Recommendation 15: Clarify the interpretation of Article 3 (1) with respect to the application of excise duty on beer by reference to the number of hectolitres/degrees Plato

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Clarify the interpretation of Article 3.1 with respect to the application of excise duty on beer by reference to the number of hectolitres/degrees Plato:** The Commission may, through the use of soft-law measures (e.g. via a Commission recommendation), clarify this interpretation. | **European Commission, Member States** |
| **Justification:** Article 3 (1) states that the excise duty levied on beer shall be fixed by reference either<br>(i) to the number of hectolitres / degrees Plato or<br>(ii) to the number of hectolitres / degrees of actual alcohol strength by volume | |

| Recommendation | Responsible stakeholder(s) |
|---|---|
| *of finished product*<br><br>The application of this provision in relation to the first indent differs across Member States which apply excise duty on beer by reference to degrees Plato. In particular, this concerns the specific case of beer to which additional sugar has been added following the fermentation stage..<br><br>While some Member States take as their reference the number of degrees Plato prior to the addition of sugar, but after the fermentation has stopped, others take as their reference the number of degrees Plato of the final product. The difference is material, since the addition of sugar at this stage would increase the number of degrees Plato, but not the alcoholic content of the beer. | |
| **Expected impact:** This recommendation is necessary in order to ensure the stability of taxation and a consistent application of excise law across different members of the EU that are applying the same method.<br><br>This evaluation takes no position as to which method of taxation is appropriate in this case; however, either one of the two possible interpretations will produce a revenue impact (either by reducing the receipts for MSs, or by increasing the applicable tax for the manufacturers of the products concerned). | |
| **Type: Non-Legislative** | |
| **Priority: Medium**<br>The Commission may, through the use of soft-law measures (e.g. via a Commission recommendation), clarify this interpretation. | |

## Table 45: Recommendation 16: Remove Article 28 from the Directive, which allowed the exemption of certain specified products

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Remove Article 28 for the Directive:** In a possible revision of Directive 92/83/EEC, Article 28 can be removed, as it is no longer relevant | **European Commission and Member States** |
| **Justification:** The UK no longer applies Article 28, and has indicated that it does not consider the provision relevant to its current needs. In the interest of clarity, it can be removed in the context of a potential revision of Directive 92/83/EEC | |
| **Expected impact:** As the UK no longer makes use of the provision, there will be no market impact. This measure would serve to simplify the Directive and remove some out-of-date provisions.<br>**Type: Legislative**<br>The implementation of this recommendation requires legislative changes to Directive 92/83/EC.<br>**Priority: Low**<br>Changes are necessary only in the interest of brevity of a potentially revised legislative act. | |

## Table 46: Recommendation 17: Investigate the need to clarify the treatment of precursors of wine

| Recommendation | Responsible stakeholder(s) |
|---|---|
| **Investigate the need to clarify the treatment of precursors of wine:** It is not clear to what extent lacking coherence in the treatment of precursors of wine creates obstacles to the free movement of these products. | **European Commission and Member States** |
| **Justification:** Must and juices are not excisable products according to the Directive but, reportedly, have to be moved with an accompanying document just like excisable products. Two Member States (FR and EL) reported that they had encountered problems concerning these products.<br>These problems have not been reported by economic operators in the context of this evaluation, but the concerned group of wine producers moving precursors of wine between the Member States might be very small and thus not represented in the survey.<br>In order to better understand if and what kinds of difficulties are caused by the current incoherence for economic operators, the subject should be further looked into. | |
| **Expected impact:** A further investigation of the issue with the concerned Member States and economic operators who potentially encounter difficulties could ensure reducing any obstacles to trade with precursors of wine. If needed a more coherent treatment of precursors of wine could be ensured. It can be identified whether the current treatment of these products creates issues with regards to lacking supervision, opening possibilities for fraud. | |

**Type: Additional research**

While this evaluation has revealed the existence of issue which could potentially affect the functioning of the internal market, there is insufficient data to support the development of a clear recommendation in the area.

**Priority: Low**

The concerned group of wine producers moving precursors of wine between the Member States might be very small and thus not represent a high priority in terms of action at EU level.

## 10.7 Maintaining the status quo

In addition to the 'positive' recommendations detailed above, inviting the Commission and Member Staets to take action, this report has identified areas in which it is recommended *not* to act, but rather to allow the continued application of the current rules.

As a general rule, if this report does not issue any recommendation in a specific area, this should be interpreted as a recommendation towards maintaining the status quo. In this section we attempt to explain our reasoning for this recommendation in some of these areas.

**Classification**

The current system of classifying alcoholic beverages for excise purposes allows the Member States to use their national excise policies to pursue a multi-dimensional set of policy goals which include both economic objectives and health objectives.

Despite the views expressed by several groups of stakeholders to the effect that the structure of excise duties on alcoholic beverages would be simplified if the duty was applied equally to all excisable alcoholic beverages on the basis of their alcohol strength, we do not anticipate that such a fundamental change to the structures of excise duties, one which would eliminate the current excise categories and link excise duty to alcohol content, would be feasible to implement and achieve satisfying outcomes for all the relevant stakeholders.

Because a majority of the Member States and other stakeholders maintain strong views on the appropriateness of the status quo, as well as uncertain oucome regarding the potential impacts (either positive or negative) of any potential change to this regime, we believe that the Commission's efforts are better directed towards improving the functioning of the system within the current framework.

**Reduced rates for small brewers**

Research shows that not all the Member States make use of Article 4.1 up to the full extent of 200,000 hl. However, most Member States do provide reduced rates for small brewers; only two Member States expressed discontent with the available limit.

As there is no evidence to suggest that those Member States which do not make full use of the provision are unduly negatively affected by the application of the provision in other Member States, and taking into account the limited degree of consensus in favour of any change, we recommend keeping in place the existing applicable limits.

**Reduced rates for small distilleries**

The research conducted in this evaluation suggests that the quantitative limit of 10 hl (20 hl in special circumstances) of pure alcohol produced by small distilleries, below which the Member States may grant reduced rates (Article 22.1), may be too small to have a sizeable impact on the market. This situation could suggest that there is scope to raise the limit in order to increase the effectiveness of the Article, if the legislator considered such an objective worth pursuing.

However, 13 out of 28 Member States indicated that they considered this limit to be appropriate, while only two Member States disagreed. As a result, attaining the unanimity

required for legislative change in this area may be difficult. As a result of this risk, this evaluation does not recommend the pursuit of legislative change in this area in order to concentrate efforts on those areas with higher potential of success.

Should the Commission consider this risk to be surmountable, the increase of the quantitative limit of 10 hl for alcohol produced by small distilleries may be revisited in a potential revision.

**Reduced rates and exemptions for specific products in specific Member States**
Those Member States which have requested and been granted special derogations to the application of the Directive strongly support maintaining them in order to continue to pursue various policy objectives nationally.

As there is no evidence to suggest that those derogations create any significant adverse effects on the EU market as a whole, on neighbouring Member States or on the Member State where they apply (and given the limited scope for attaining unanimity required for legislative change in the area), we consider that maintaining the status quo in this respect is appropriate.

# Appendices

**Appendix 1 – *Evaluation Matrix and Evaluation Design***

**Appendix 2 - *Consultation strategy synopsis report***

**Appendix 3 – *Survey questions to Member States***

**Appendix 4 – *Survey questions to economic operators***

**Appendix 5 – *Open public consultation questions***

**Appendix 6a - *In-depth case study on classification issues***

**Appendix 6b – *In-depth case study on classification issues – quantification***

**Appendix 7 – *In-depth case study on reduced rates for small producers***

**Appendix 8 – *In-depth case study on the management of exemptions for denatured alcohol***

**Appendix 9 – *In-depth case study on exemptions for alcohol for private consumption***

**Appendix 10a - *Public consultation summary report***

**Appendix 10b - *Public consultation – results for publications***

**Appendix 11 – *Ad-hoc contributions***

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