

**Philip Morris International's Views on
the Revision of the Tobacco Excise Directive**

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[input to Q37 of the EU Commission's Public Consultation on Excise Duties applied to Manufactured Tobacco
and the Possible Taxation of Novel Products]

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Introduction

Excise taxes are consumption taxes applied to specific goods in order to achieve a number of objectives: curbing consumption of a product, correcting for a negative externality, generating tax revenues. Tobacco excise is no exception. For example, recital 2 of Council Directive 2011/64/EU¹ (the “Tobacco Excise Directive” or “TED”), states: *“The Union’s fiscal legislation on tobacco products needs to ensure the proper functioning of the internal market and, at the same time, a high level of health protection [...]”*.

Traditionally, in the area of tobacco taxation the promotion of public health goals has been articulated into two key priorities: preventing smoking initiation and encouraging cessation.

Since the time the Tobacco Excise Directive was last updated in 2007-2010, the tobacco market has started to change radically: an entirely new category of products, including electronic cigarettes and heated tobacco products (together “non-combustible products”) have appeared on the market and grown in demand. These products are not covered by the TED.

The defining feature of this new category of products is that unlike combustible tobacco products (i.e. cigarettes; smoking tobacco such as fine-cut, pipe or other manufactured tobacco; cigars and cigarillos), they operate by heating a liquid (electronic cigarettes) or a specially prepared tobacco mixture (heated tobacco products) to deliver a vapour that is not smoke, as there is no combustion of the tobacco.

As no smoke is produced, these products generate significantly lower yields of harmful and potentially harmful constituents compared to combustible tobacco products, such as cigarettes. This technological development offers an unprecedented opportunity to improve public health by offering better alternatives to adult smokers who would otherwise continue to smoke.

Regulatory and fiscal policies play a crucial role ensuring that such an opportunity is realised, including making novel non-combustible alternatives available to and affordable for adult smokers. As some of the leading scholars in tobacco control have recently stated in an article published in the *New England Journal of Medicine*: *“Policymakers should consider an approach that differentially taxes nicotine products in order to maximize incentives for tobacco users to switch from the most harmful products to the least harmful ones.”*²

The Tobacco Products Directive (Dir. 2014/40) defines and regulates novel tobacco products, including novel smokeless tobacco products (art. 2, (5) and (14)). “Tobacco products for smoking” are also defined (art. 2 (9)).

The regulatory framework could be further enhanced with product standards for scientifically substantiated reduced risk products. These products should be subject to lower taxation than higher risk products according to the principle of higher risk-higher tax, lower risk-lower tax. Sufficient scientific evidence is already available today to conclude that non-combustible

¹ Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco.

² Frank J. Chaloupka, Ph.D., David Sweanor, J.D., and Kenneth E. Warner, Ph.D., *Differential Taxes for Differential Risks — Toward Reduced Harm from Nicotine-Yielding Products*, *n engl j med* 373;7

products, such as heated tobacco products, should be treated differently from combustible products as they have vastly different risk profiles. This should be reflected in tax policy. Therefore, if countries decided to levy excise duty on non-combustible, reduced risk products, PMI recommends that their excise duty level should be below the lowest excise duty level applied to any combustible tobacco product. In the context of the revision of the Tobacco Excise Directive, a clear category for such non-combustible products should be created without setting any minimum EU excise duty requirement.

Revision of the Tobacco Excise Directive

Many scientific experts agree that nicotine, while addictive, is not the primary cause of smoking-related diseases. It is the toxic compounds that are found in cigarette smoke – most of which are formed when tobacco is combusted. Therefore, products that deliver nicotine without combustion have the potential to reduce individual risk compared to smoking, and if they prove to be an acceptable alternative for adult smokers, ultimately reduce population harm.

Electronic cigarettes are increasingly recognized as less harmful than combustible tobacco products. In 2018, Public Health England confirmed that *“Vaping poses only a small fraction of the risks of smoking and switching completely from smoking to vaping conveys substantial health benefits over continued smoking.”*³. There is also growing evidence that e-cigarettes are a gateway out of smoking rather than into smoking. In the UK alone, 1.5 million smokers have completely switched to electronic cigarettes.⁴ Several studies have concluded that electronic cigarettes are at least as effective as nicotine replacement therapies (NRTs) at encouraging adult smokers to give up cigarettes.⁵ For example, according to Cancer Research UK, electronic cigarettes are now the most popular form of smoking cessation support in the UK⁶, and experts have concluded that on average electronic cigarettes are approximately 50% more effective than using no aid or over the counter NRTs.⁷

PMI entered the electronic cigarette market in 2014 through the acquisition of Nicocigs Ltd., a leading supplier of electronic cigarettes in the UK and in Ireland⁸, and is also present with

³ Evidence Review of e-cigarettes and heated tobacco products 2018, a Report Commissioned by Public Health England, February 2018.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/457102/E-cigarettes_an_evidence_update_A_report_commissioned_by_Public_Health_England_FINAL.pdf

⁴ Use of electronic cigarettes (vapourisers) among adults in Great Britain, ASH UK, May 2017

⁵ Glasser, AM, et al., Overview of electronic nicotine delivery systems: A systematic review, American Journal of Preventative Medicine, November 2016; O’Leary, R., et al., Clearing the air: A systematic review on the harms and benefits of e-cigarettes and vapour devices, Centre for Addictions Research of BC, 2017; McRobbie, H., et al., electronic cigarettes for smoking cessation and reduction, Cochrane Database of Systematic Reviews, 2014; Brown, J., et al., Real-world effectiveness of e-cigarettes when used to aid smoking cessation: A cross-sectional population study, Addiction, 2014.

⁶ Cancer Research UK, E-cigarettes in stop smoking services, July 2016.

⁷ West, R., et al., Estimating the population impact of e-cigarettes on smoking cessation in England, Addiction, 2016.

⁸ Nicocigs Ltd. is the market leader in Ireland, and second largest supplier in the UK.

its electronic cigarettes in Spain. PMI's first novel non-combustible tobacco product, a electrically heated tobacco product (hereafter "EHTP"; called "HEETS"), to be used with an electronic heating device ("IQOS"), is now available in the majority of EU Member States and in numerous countries worldwide. To date, over five million adult smokers worldwide have switched from cigarettes to using PMI's heated tobacco products. PMI's commitment and ambition is to replace cigarettes as soon as possible with better alternatives to smoking for the millions of men and women who would otherwise continue to smoke. PMI's resource allocation continues to shift toward smoke-free products (heated tobacco products and e-cigarettes), which in 2017 accounted for 74 percent of global R&D expenditure and 39 percent of global commercial spend⁹. In 2017, smoke-free products represented approximately 4.4 percent of PMI's shipment volume and in the EU, over the past 12 months, the number of IQOS users has quadrupled to over 1.2 million.

PMI has published over 35 peer-reviewed articles on IQOS/HEETS covering the different steps of our scientific assessment program. To assess reduced toxicity, reduced exposure to harmful chemicals and reduced risk, these articles include aerosol chemistry, toxicology and clinical studies, all in line with applicable Good Laboratory and Good Clinical Practices. These studies demonstrate that the EHTP aerosol contains significantly reduced levels of toxicants compared with cigarette smoke and that this leads to a significantly reduced exposure to toxicants in smokers who switch to IQOS. Furthermore, all studies conducted in laboratory models demonstrate that reduced toxicant emission significantly reduces the toxicity and the disease risk of the EHTP aerosol compared with cigarette smoke. We believe that the totality of the evidence generated across a broad array of scientific studies demonstrates that switching completely to IQOS can present less risk of tobacco-related disease than cigarettes.

In addition, several government reports and other independent publications¹⁰ confirm our results on the drastically reduced levels of harmful chemicals in EHTP aerosol compared to cigarette smoke. This independent research from around the world helps demonstrate to governments, public health experts, the scientific community and civil society not only that PMI's research is robust, but that IQOS has the potential to play a pivotal role in changing the lives of millions and make a positive impact on public health.

On the regulatory front, the Tobacco Products Directive¹¹ already includes electronic cigarettes and novel tobacco products: it is desirable that a similar forward-looking approach informs the revision of the TED. The EU Commission has the opportunity to re-align the TED with the changed reality of the market, and to ensure that it remains fit for purpose for the years to come.

However, the necessity to realign the TED with the changed reality of the market does not imply that electronic cigarettes or heated tobacco products *should* be subject to a harmonized EU excise tax. On the contrary, imposing an excise duty on these new products could render

⁹ PMI Sustainability Report 2017 page 4 and 25, available [here](#)

¹⁰ For a full list of independent scientific studies and reports on IQOS see Philip Morris International's Scientific Update, Issue 05, June 2018, available [here](#).

¹¹ Council Directive 2014/40/EU of 3 April 2014 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the manufacture, presentation and sale of tobacco and related products and repealing Directive 2001/37/EC.

them less affordable, thus denying millions of European adult smokers the opportunity to find a reduced-risk alternative to smoking that meets their preferences and budget.

In order to ensure that these products remain available and affordable to adult smokers, the TED should include:

- No EU minimum excise duty requirement for electronic cigarettes; and
- No EU minimum excise duty requirement for heated tobacco products.

A minimum EU excise duty requirement for non-combustible products could unnecessarily limit the ability of the Member States to provide the tax differential (incorporating individual product characteristics), necessary to facilitate adult smokers' transitioning out of the combustible product categories.

Notwithstanding the fact that non-combustible products are out of scope of the current TED, fourteen Member States have introduced an "excise" tax on electronic cigarettes¹² and fourteen Member States have created a separate excise duty category for heated tobacco products¹³, each with a slightly different approach to determining the excise duty base, structure and level. At the time of writing, another two Member States have – pending the legislative process - decided to create a separate excise duty category for heated tobacco products.¹⁴

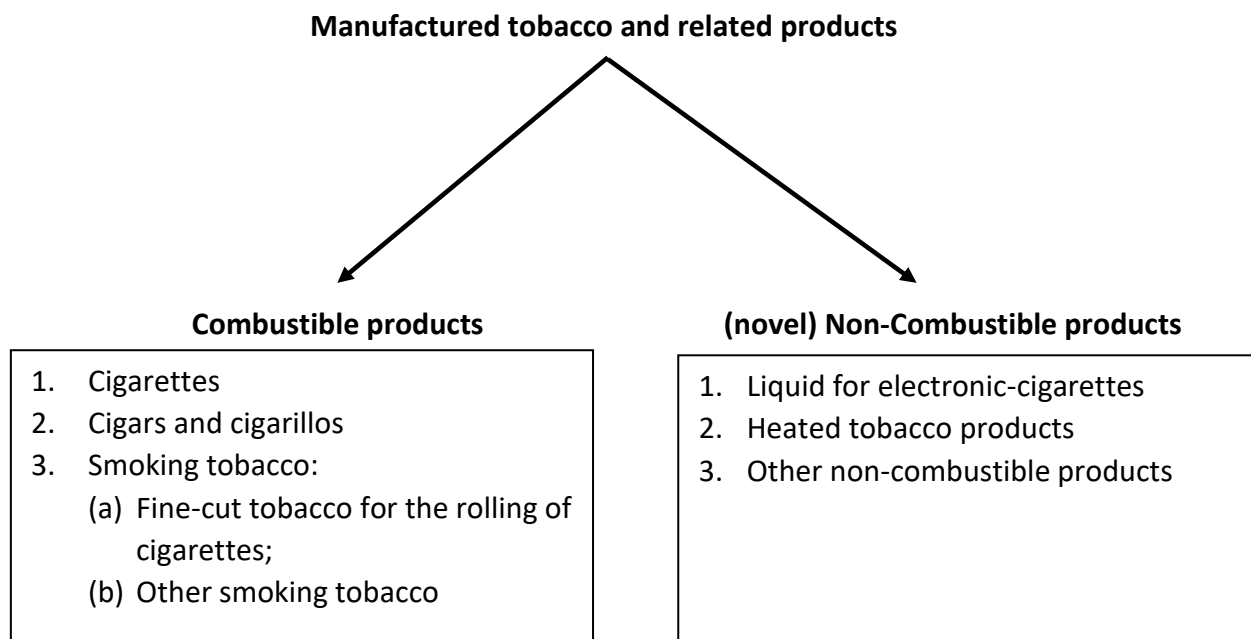
Under the current TED, the EU Commission has an obligation to assess whether such different approaches within the EU could constitute an obstacle to the proper functioning of the Internal Market, in which case a harmonising intervention would be necessary.

It is PMI's view that the concurrent objectives to ensure the proper functioning of the internal market and a high level of health protection for European citizens are best achieved by broadening the scope of the TED to include products such as electronic cigarettes and heated tobacco products. This could be done by creating two chapters within the TED: one for **combustible** products, covering the existing harmonised product categories, and one for **(novel) non-combustible** products, the latter with no EU minimum excise duty requirement, as outlined in the diagram below.

¹² Croatia, Cyprus, Estonia, Finland, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Portugal, Romania, Slovenia, Sweden.

¹³ Bulgaria, Croatia, Cyprus, Denmark, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Portugal, Romania, Slovakia, Slovenia.

¹⁴ Czech Republic, the United Kingdom.



Such an approach would ensure that those Member States that wish to impose an excise duty on non-combustible products can do so in a consistent and effective manner, without hindering the free circulation of goods within the internal market, while preserving the sovereignty of the Member States that have so far decided not to impose an excise duty on non-combustible products.

In the same context, the gradual harmonization of minimum excise requirements should continue for all combustible products. Member States should also make use of the opportunity granted to them within the current TED framework to continue with the approximation of excise duty levels between all combustible product categories, taking into account their individual product characteristics.

In summary, we believe that the revision of the TED offers the EU an opportunity to fulfil its mandate to ensure a high level of health protection for European citizens and the proper functioning of the Internal Market, while providing legal and regulatory certainty to economic operators and bringing the TED in line with the new conditions of the market.

Scope of the Tobacco Excise Directive

Directive 2011/64/EU lays down the general principles for the harmonisation of the structure and rates of the excise duty on manufactured tobacco products, with the objective “to ensure the proper functioning of the internal market and, at the same time, a high level of health protection”.¹⁵

Article 2 defines the scope of application of the TED, by defining “manufactured tobacco products” as the following:

- (a) cigarettes;
- (b) cigars and cigarillos;
- (c) smoking tobacco.

Any product, whether it contains tobacco or not, that does not fit into one of these three categories, must be considered outside the scope of the TED.

The requirements that a product must fulfil in order to fit into the aforementioned categories are laid down in Articles 3 to 5 (emphasis added):

Article 3 – Cigarettes

“1. For the purpose of this Directive cigarettes shall mean:

- a) rolls of tobacco capable of being **smoked** as they are and which are not cigars or cigarillos;*
- b) rolls of tobacco which, by simple non-industrial handling, are inserted into cigarette-paper tubes; and/or*
- c) rolls of tobacco which, by simple non-industrial handling, are wrapped in cigarette paper. [...]*”

Article 4 – Cigars and Cigarillos

*“1. For the purposes of this Directive the following shall be deemed to be cigars or cigarillos if they can be and, given their properties and normal consumer expectations, are exclusively intended to be **smoked** as they are:*

- a) rolls of tobacco with an outer wrapper of natural tobacco;*
- b) rolls of tobacco with a threshed blend filter and outer wrapper of the normal colour of a cigar, of reconstituted tobacco [...] which can be (and are) exclusively intended to be **smoked** as they are. [...]*”

Article 5 – ‘Smoking Tobacco’

“1. For the purposes of this Directive smoking tobacco shall mean:

- a) tobacco which has been cut or otherwise split, twisted or pressed into blocks and is capable of being **smoked** without further industrial processing;*

¹⁵ Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco, recital 2.

*b) tobacco refuse put up for retail sale which does not fall under Article 3 and Article 4(1) and which can be **smoked**. [...]*”

It is clear from the above that in order for a product to fall into any of the three manufactured tobacco product categories as defined in the TED it must be intended to be smoked or capable of being smoked.

The historical evolution of EU legislation on tobacco excise confirms the legislator’s intention to limit the scope of the TED to **smoking** products. As a matter of fact, smokeless tobacco products used to be included within the scope of tobacco excise, but were explicitly removed in 1992 with the entering into force of Council Directive 92/80/EEC¹⁶. Article 1 of Council Directive 92/80/EEC recites (emphasis added):

“Directive 72/464/EEC is hereby amended as follows:

1. Article 2 shall be deleted;

2. Article 3 shall be amended as follows:

(a) point (c) of paragraph 1 shall be replaced by the following :

'(c) smoking tobacco:

— fine-cut tobacco for the rolling of cigarettes,

— other smoking tobacco';

(b) points (d) and (e) shall be deleted;”

Article 3 of Council Directive 72/464/EEC recites (emphasis added):

“The following shall be considered to be manufactured tobacco:

(a) cigarettes

(b) cigars and cigarillos

(c) smoking tobacco

(d) snuff

(e) chewing tobacco.”

The removal of points (d) and (e) has explicitly excluded smokeless tobacco products from the “harmonised” categories and therefore from the scope of application of Directive 92/80/EEC and its subsequent revisions, including Directive 2001/64/EU.

It emerges from the above that both heated tobacco products and electronic cigarettes fall outside the remit of the TED insofar as they are not for smoking, i.e., they are not intended or capable of being smoked, but smokeless products because of the “absence of combustion” as their defining characteristic.

¹⁶ Council Directive 92/80/EEC of 19 October 1992 on the approximation of taxes on manufactured tobacco other than cigarettes.

Electronic cigarettes and heated tobacco products taxation in the Member States

In the absence of a harmonised approach to the excise duty treatment of electronic cigarettes and heated tobacco products at the EU level, various Member States have established national tax regimes for these new products.

Member States' prerogative to impose indirect taxes on non-excise goods (i.e., on goods that are not included in the harmonised excise tax categories) is guaranteed under the EU excise tax regime, as established by Article 3 of Directive 2008/118/EC¹⁷ (the "Circulation Directive"):

"3. Member States may levy taxes on:

1) products other than excise goods; [...]"

At the time of writing, fourteen Member States have introduced some form of taxation on electronic cigarettes.

The approach taken to the definition of a tax base varies from country to country:

- Ten Member States (HR; CY; EE; EL; FI; HU; IT; PL; LIT; SWE) tax all liquids for use in electronic cigarettes, whether or not they contain nicotine, at a flat rate per millilitre;
- Three Member States (PT; RO; SI) only tax liquid for use in electronic cigarettes that contain nicotine, on a flat rate per millilitre;
- Latvia has introduced a compound tax system, whereby liquids for use in electronic cigarettes are taxed on a flat rate per millilitre, to which a tax per milligram of nicotine is added.

Tax rates vary from zero to approximately 0.4 Euro per millilitre of electronic cigarette liquid¹⁸.

As regards heated tobacco products, fourteen Member States introduced specific tax regimes, again, following different approaches:

- Eleven Member States (BG; DK, HR; CY; EL; LV; LIT; PL; RO; SK; SI) tax heated tobacco products at a flat rate per kilogram of tobacco mixture;
- Two Member States (HU; IT) tax heated tobacco products at a specific rate per unit of product;
- Portugal uses a mixed system based on weight of the tobacco mixture and retail selling price, with a minimum excise duty per kilogram of tobacco mixture applied.

The question for the policy maker to address is whether such different approaches to the taxation of non-combustible products within the EU prejudices the achievement of the objectives of the TED, i.e., to ensure the proper functioning of the Internal Market and a high level of health protection, and if it interferes with other broader objectives, such as guaranteeing a level competitive playing field and protecting the integrity of the tax systems in the Member States.

¹⁷ Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC.

¹⁸ to which in Latvia the additional tax element based on nicotine content must be added

Advantages of the inclusion in the scope of the Tobacco Excise Directive

The existence of a harmonised excise tax category is not a necessary (or sufficient¹⁹) condition for the imposition of indirect taxes in the individual Member States. It is however a necessary condition for both economic operators and Member States to secure the common arrangements for the collection of excise duty and the circulation and monitoring of excise goods within the Union, including:

- a single tax trigger;
- harmonised administrative procedures;
- free movement of goods within the EU under duty suspension;
- centralised monitoring of movements.

These measures play a crucial role in ensuring that the imposition of indirect taxes on goods in Member States does not hinder the proper functioning of the internal market and in protecting the integrity of the excise duty system in the presence of cross-border movement of excise goods.

It is our view that the current set up for the tax treatment of non-combustible products within the EU, by foregoing the benefit of harmonisation, effectively impairs the achievement of the objectives of the Tobacco Excise Directive, and interferes with the broader aims of the Single Market, in that it:

- 1) generates additional administrative, technical, and financial burden for operators that wish to trade within the Single Market;
- 2) impairs the ability to correctly monitor the movement of goods subject to excise and therefore undermining the integrity of their tax collection system;
- 3) discriminates European consumers and economic operators by limiting their access to the market for “novel products”; and ultimately
- 4) limits adult smokers’ access to potentially reduced risk alternatives to smoking, thus reducing their ability to find a reduced risk alternative to smoking that works for them.

¹⁹ Precedents exist of excise goods for which no minimum tax rate is set, e.g., for alcoholic beverages.

Conclusion

PMI fully supports tobacco harm reduction as an essential element of public health policy, and fully endorses regulatory and fiscal policies for reduced risk products that enable and promote consumer switching from smoking to using reduced risk alternatives, including electronic cigarettes, heated tobacco products, and other non-combustible nicotine and tobacco products. In fact, PMI's ambitious objective is to convince all adult smokers who would otherwise continue using combustible tobacco products to switch to reduced risk products as soon as possible.

Heated tobacco products and electronic cigarettes are alternatives to smoking that have the potential to significantly reduce individual risk and population harm. These products differ fundamentally from combustible tobacco products as they deliver vapour instead of smoke.

These products have been included and are regulated by the Tobacco Products Directive.

Similarly to the Tobacco Products Directive, the TED should include and regulate products, such as electronic cigarettes, heated tobacco products and other nicotine delivery products that may be developed in the future. This could be achieved by creating two chapters within the TED: one for **combustible** products, covering the existing harmonised product categories, and one for **(novel) non-combustible** products. The latter should have no EU minimum excise duty requirement, in order to accommodate the different approaches in the EU Member States and subject to the same harmonised circulation rules for holding and movement.

It is PMI's view that nicotine and tobacco products should be taxed according to their risk profile: higher risk-higher tax, lower risk-lower tax. Adequate scientific evidence is already available today to conclude that non-combustible products such as heated tobacco products should be treated differently from combustible products as they have different risk profiles. If countries decided to levy excise duty on non-combustible products, PMI recommends that their excise duty level should be substantially lower than that of cigarettes and always below the lowest excise duty level applied to any combustible tobacco product.

In this context, PMI supports a gradual approximation of tax levels of all combustible tobacco products (while taking into account their individual product characteristics) at Member State level, which is allowed by the existing TED provisions.

Annex - Proposed excise tax framework for non-combustible products

In essence, there is no need for defining terms like “smoke”, “smoking”, or “heating”. On the contrary, there is a clear need to define the category of Heated Tobacco Products, electronic cigarettes and other possible products of the future.

The key difference between `heated tobacco products` and `cigarettes` as well as other `tobacco products for smoking` is the absence of `combustion`. The distinction between tobacco products for `smoking` and `smokeless` tobacco products has been provided in the revised TPD, the basis of which is the presence or absence of `combustion`.

I. Liquids for electronic cigarettes

Definition: *Any liquid solution intended to be consumed in electronic cigarettes.*

Tax base: The excise tax shall be based on the volume of liquid solution that can be consumed in electronic cigarettes, expressed in Euro per millilitre.

Tax level: Because electronic cigarettes are still a relatively new product, the tax bearing capacity remains uncertain and needs to be tested in practice. Therefore, **no** EU minimum excise duty requirement should be included in the TED.

Electronic cigarettes come in different forms and shapes – disposable; cartridge; tanks, and so on. In PMI’s view, if a Member State decides to levy an excise duty on electronic cigarettes, it should be on the consumable, not the device. A practical and equitable excise duty base would be the volume of liquid (“e-liquid”), because all electronic cigarettes contain e-liquid or use e-liquid sold separately in bottles. We suggest a simple specific tax based on the volume of liquid. Specific taxes are easy to administer and generate more predictable tax revenues, and are widely considered as a best practice.

II. Heated tobacco products

Definition: *a manufactured tobacco product that delivers a vapour without combustion of the tobacco mixture.*

Tax base: The excise tax shall be based on the weight of tobacco mixture, expressed in Euro per kilogram.

Tax level: Because heated tobacco products are still a relatively new consumer product, the tax bearing capacity remains uncertain and needs to be tested in practice. Therefore, **no** EU minimum excise duty requirement should be included in the TED.

With regard to the tax base, we recommend a simple specific tax based on the weight of tobacco mixture. Specific taxes are easy to administer, generate more predictable tax revenues, and are widely considered as best practice. No excise duty should be levied on devices, spare parts, and non-tobacco elements such as paper and mouthpieces.

III. Other non-combustible products

Definition: *A manufactured liquid solution or tobacco product, not involving combustion of the tobacco mixture, intended for inhalation of nicotine containing vapor, which does not fall into the following categories: liquids for electronic cigarettes, heated tobacco product; and is not snuff, chewing tobacco or tobacco for oral use as defined in Directive 2014/40/EU.*

Tax base: The excise tax shall be based on the weight of the tobacco mixture expressed in Euro per kilogram and on the volume of liquid expressed in Euro per milliliter.

Tax level: Because the tax bearing capacity of these products is uncertain and needs to be tested in practice, **without** an EU minimum excise duty requirement.

With regard to the tax base, we suggest a simple specific tax based on the weight of the tobacco mixture and on the volume of liquid in the product. Specific taxes are easy to administer, generate more predictable tax revenues, and are widely considered as best practice. The excise duty should be levied only on the consumable, not on the device, accessories or spare parts.