



# **Study on Council Directive 92/83/EEC on the structures of excise duty on alcohol and alcoholic beverages**

Final Report

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Directorate General for Taxation and Customs Union  
Directorate C – Indirect Taxation and Tax Administration  
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EUROPEAN COMMISSION

# **Study on Council Directive 92/83/EEC on the structures of excise duty on alcohol and alcoholic beverages**

Final Report

Directorate-General for Taxation and Customs Union

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## Acronyms and Abbreviations

ABV	Actual Alcoholic Strength by Volume
AFC	Alcohol as a Flavour-Carrier
AWP	Aromatised Wine Products
bn	Billion
BR	Better Regulation
BTA	Bilateral Trade Agreement
BTI	Binding Tariff Information
CAGR	Compound Annual Growth Rate
CBA	Cost-Benefit Analysis
CDA	Completely Denatured Alcohol
CJEU	Court of Justice of the European Union
CN	Combined Nomenclature
CNEN	Combined Nomenclature Explanatory Note(s)
DG AGRI	Directorate General for Agriculture and Rural development
DG COMP	Directorate-General for Competition
DG GROW	Directorate General for Internal Market, industry, Entrepreneurship and SMEs
DG SANTE	Directorate General for Health & Food Safety
DG TAXUD	Directorate General for Taxation and Customs Union
DG TRADE	Directorate General for Trade
EBTI	European Binding Tariff Information
EC	European Commission
EDT	Excise Duty Tables
EMCS	Excise Movement and Control System
EPC	Excise Product Code
ET	Ethyl Alcohol
EU	European Union
FESS	Functional Excise System Specification
FAB	Flavoured Alcoholic Beverage
FPG	Fiscalis Project Group
hl	Hectolitre
hlpa	Hectolitre of Pure Alcohol
HS	Harmonised System
IA	Impact Assessment
IP	Intermediate Products
IIA	Inception Impact Assessment
ISSG	Inter-Service Steering Group
ITEG	Indirect Tax Expert Group
lpa	Litre of Pure Alcohol
MCA	Multi-Criteria Analysis
mn	Million
MS	Member State(s)
NGO	Non-Governmental Organisation
OFB	Other Fermented Beverages
OLAF	European Anti-fraud Office
OPC	Open Public Consultation
PDA	Partly Denatured Alcohol
PDO / PGI	Protected Designation of Origin / Protected Geographical Indication
REFIT	Regulatory Fitness and Performance Programme
RTD	Ready-to-Drink products
SME	Small and Medium-sized Enterprise
TFEU	Treaty on the Functioning of the European Union
ToR	Terms of Reference
WHO	World Health Organisation

## **Abstract**

The purpose of this Study is to contribute to the Impact Assessment of a possible revision of Council Directive 1992/83/EEC on the harmonisation of the structure of excise duty on alcohol and alcoholic beverages. The Study includes a baseline assessment of a series of issues emerged from the previous evaluation of the Directive and analyses how these problems may evolve if no EU action is taken. Secondly, the Study formulates a set of possible policy options to address these problems, assesses their likely impacts (legal certainty, market functioning, administrative costs, tax revenues, alcohol control policies, fraud etc.), and compares the outcome with the baseline situation.

The main issues analysed in this Study includes: the uncertainties in the excise duty classification of certain new 'borderline' products; the functioning of Article 27 concerning the exemptions extended to denatured alcohol; the reduced rates applicable to low-strength alcoholic beverages and to small producers; the exemption for private production and home consumption; and the disparities of methods for measuring the Plato degree of sweetened and flavoured beer. The underlying evidence is based on the triangulation of in-depth interviews with stakeholders from the Member States, the results of an open public consultation online, a quantitative analysis of the market, and the review of other literature and documentary sources.

## 1 INTRODUCTION

### 1.1 Nature and purpose of the assignment

This Final Report (the 'Report') has been prepared in the framework of the assignment titled 'Study on Council Directive 92/83/EEC on the structures of excise duty on alcohol and alcoholic beverages' (the 'Assignment' or the 'Study'). The Report is submitted to the European Commission – Directorate General for Taxation and Customs Union (DG TAXUD) by a grouping led by Economisti Associati and including the Centre for European Policy Studies (CEPS), CASE - Center for Social and Economic Research, wedoIT-solutions GmbH, and ECOPA ('the Consortium') and involving Ipsos as sub-contractor for this specific contract (hereinafter collectively referred to as 'the Consultant').

The overall purpose of this Study is to contribute to the Impact Assessment (IA) of the policy options for a revision of Directive 92/83/EEC ('the Directive'). The Study has three main objectives, namely:

- gather and analyse the evidence on the existing costs and benefits arising from the Directive, with the main focus on **analysing the scale of the problems** identified in the previous evaluation study;<sup>1</sup>
- assess the evolution of the problems if **no further action** at EU level is taken (dynamic baseline scenario);
- assess the economic, social and environmental impacts of the **possible options to address the problems identified**.

Additionally, the Assignment envisages assisting the Commission in conducting an **Open Public Consultation** (OPC) to collect stakeholders' comments and feedback on the issues identified and the possible options for a revision of the Directive.

In accordance with its objectives, the Study focused on a set of specific issues that emerged from the evaluation study completed in 2016 (the 'Ramboll Evaluation') and were taken up in the following Commission Report to the Council.<sup>2</sup> The Council discussed the Commission Report and adopted conclusions on 6 December 2016.<sup>3</sup> In these Conclusions the Council requested the Commission to carry out an impact assessment on the possible revision of Directive 92/83/EEC. On 1 March 2017, DG TAXUD adopted an Inception Impact Assessment (IIA)<sup>4</sup> and a Consultation Strategy<sup>5</sup> that laid out the general framework of the exercise and the perimeter of the problem areas and policy options under scrutiny.

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<sup>1</sup> Ramboll Management Consulting, Coffey, Europe Economics, 'Evaluation of Council Directive 92/83/EEC on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages', 2016. Hereinafter: Ramboll Evaluation (2016).

<sup>2</sup> 'Report from the Commission to the Council on the evaluation of Council Directive 92/83/EEC on the structures of excise duties on alcohol and alcoholic beverages', Brussels, 28.10.2016, COM(2016) 676 final. Hereinafter: COM(2016) 676 final.

<sup>3</sup> 'Council Conclusions on the Commission Report to the Council on the evaluation of Council Directive 92/83/EEC on the structures of excise duties on alcohol and alcoholic beverages', 06.12.2016. Hereinafter: Council Conclusions (2016).

<sup>4</sup> 'Inception Impact Assessment on the Structures of excise duties on alcohol and alcoholic beverages', 01.03.2017. Hereinafter: IIA (2017).

<sup>5</sup> 'Impact Assessment on the possible revision of Council Directive 1992/83/EEC of 19 October 1991 on the harmonisation of the structures of excise duty on alcohol and alcoholic beverages - Consultation strategy', available at:

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/alcohol\\_consultation\\_strategy.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/alcohol_consultation_strategy.pdf)

## 1.2 Background to the initiative

### 1.2.1 The legal framework

In late 1992, the Council adopted **Directive 92/83/EEC** on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages ('the Directive').<sup>6</sup> The Directive provisions are essentially of three kinds:

- Provisions aimed at classifying alcohol and alcoholic beverages – as defined in the Combined Nomenclature – into five different fiscal categories.
- Provisions on the tax structures applicable to the various fiscal categories.
- Provisions on the exemptions and reduced rates for certain products.

The tax regimes established in the Directive for alcohol and alcoholic products are summarised in Table 1 below.

**Table 1– The excise duty provisions applicable to alcohol and alcoholic products**

Fiscal Category	Tax Structures and Rates
<b>Beer</b>	<ul style="list-style-type: none"> <li>• Excise duty fixed by reference to: (i) the number of hectolitres of finished product; AND (ii) the degree Plato OR (ii) the actual alcoholic strength by volume (ABV).</li> <li>• Possibility of applying reduced rates to small producers (&lt;200,000 hectolitres (hl) per year), not less than 50% of the standard rate, as well as to low-strength products (below 2.8% vol).</li> <li>• Possibility of exempting beer produced for private consumption.</li> </ul>
<b>Wine</b>	<ul style="list-style-type: none"> <li>• Excise duty fixed by reference to the number of hectolitres of finished product.</li> <li>• Possibility of applying reduced rates to low-strength products (below 8.5% vol).</li> <li>• Possibility of exempting wine produced for private consumption.</li> </ul>
<b>Fermented beverages other than wine and beer (OFB)</b>	<ul style="list-style-type: none"> <li>• Excise duty fixed by reference to the number of hectolitres of finished product.</li> <li>• Possibility of applying reduced rates to low-strength products (below 8.5% vol).</li> <li>• Possibility of exempting OFB produced for private consumption.</li> </ul>
<b>Intermediate products (IP)</b>	<ul style="list-style-type: none"> <li>• Excise duty fixed by reference to the number of hectolitres of finished product.</li> <li>• Possibility of applying a single reduced rate to low-strength products (below 15% vol), not less than 40% of the standard rate AND of the rate applied to wine and OFB).</li> <li>• Possibility of applying a single reduced rate for certain products of a regional and traditional nature, not less than 50% of the standard rate AND of the minimum rate for intermediate products.</li> </ul>
<b>Ethyl alcohol</b>	<ul style="list-style-type: none"> <li>• Excise duty fixed by reference to the number of hectolitres of pure alcohol.</li> <li>• Possibility of applying reduced rates to low-strength products (below 10% vol).</li> <li>• Special reduced rates applicable in specific Member States (MS), i.e. BG, CZ, HU, RO and SK.</li> </ul>
<b>Exemptions</b>	<ul style="list-style-type: none"> <li>• MS shall exempt alcohol when completely denatured (Article 27(1)(a)), or denatured and used for the manufacture of any product not for human consumption (Article 27(1)(b)).</li> <li>• MS shall also exempt alcohol when used to produce vinegar, medicines, flavours for foodstuffs and non-alcoholic beverages, or foodstuffs (Article 27(1) from (c) to (f)).</li> <li>• MS may exempt alcohol used for scientific or medical purposes, for manufacturing products that do not contain alcohol, or component products that are not subject to excise duty (Article 27(2)).</li> </ul>

**Source:** Directive 92/83/EEC.

While the Directive defines the structures of excise duty, and for this reason it is sometimes referred to simply as the 'Structures Directive', the minimum rates of excise

<sup>6</sup> Council Directive 92/83/EEC of 19 October 1992 on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages, OJ L 316, 31.10.1992, p. 21. Later amended in 2004 and 2007: 'Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded' OJ L 236, 23.09.2003, p. 33; and 'Act of accession of Bulgaria and Romania' OJ L 157, 21.06.2005, p. 29

duty are set in a separate act, the **Directive 92/84/EEC**,<sup>7</sup> which does not fall within the scope of this Study.

The EU excise system is regulated by **Directive 2008/118/EC** (also known as the 'Horizontal Directive'), which laid down the general provisions applicable to harmonised excise goods, and leaving Member States free to establish non-harmonised consumption taxes on other goods.<sup>8</sup> Among other things, the Horizontal Directive regulates how and where excise duties are paid and collected, the regime applicable to operators under duty suspension, and the rules for distant selling. It also laid the basis to create a computerised procedure to monitor the movement of excise goods, which has been later adopted with the name of **Excise Movements and Control System (EMCS)**.<sup>9</sup> Since January 2011, all movements of excise goods under suspension of excise duty are carried out under EMCS.

### 1.2.2 The Evaluation of Directive 92/83/EEC and the issues at stake

The Directive was selected for a retrospective evaluation under the Commission's Regulatory Fitness and Performance Programme (REFIT), and an independent evaluation study was carried out in 2014/2016 by a consortium led by *Ramboll Management Consulting* (hereinafter the 'Ramboll Evaluation').<sup>10</sup> The recommendations and findings of the Ramboll Evaluation were largely taken up in the subsequent Commission's report, which was submitted to the Council in October 2016 (hereinafter the 'Commission Report').<sup>11</sup> According to it, while the Directive has proven to be effective and generally appropriate for the collection of excise duties, some inefficiencies however persist, causing possible distortions of the internal market and generating unnecessary administrative and compliance costs for tax administrations and economic operators. The ECOFIN Council discussed the Commission Report and adopted its conclusions in December 2016, which among other things invited the Commission to carry out the relevant background work (technical analysis, public consultations and impact assessment) for a possible revision of the Directive.<sup>12</sup>

In March 2017, the Commission published the Inception Impact Assessment on a possible revision of the Directive, and laid down the problem areas to be assessed and a preliminary set of potential policy options. Based on that, the issues at stake in this Study have been structured into six problem areas, as outlined in Table 2 below.

**Table 2 – Overview of the issues at stake**

#	Problem area	Problem outline
1	<b>Classification of certain alcoholic beverages</b>	The Directive defines the categories of alcoholic products subject to harmonised excise duty in accordance with their customs classification, i.e. the Combined Nomenclature (CN) codes. The correspondence between the fiscal categories and the CN codes is however not straightforward especially for certain novel products of the 'other fermented beverage' class, which did not exist when the Directive was adopted and may arguably take advantage in certain circumstances of an unduly favourable tax treatment. Classification uncertainties may lead to disparities of treatment across MS and similar products, with possible adverse effect on fair competition, tax revenues, and legal disputes. There are also uncertainties with the interpretation of the notion 'entirely

<sup>7</sup> Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages, OJ L 316, 31.10.1992, p. 29.

<sup>8</sup> Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, OJ L 9, 14.1.2009, p. 12.

<sup>9</sup> Decision No 1152/2003/EC of the European Parliament and of the Council of 16 June 2003 on computerising the movement and surveillance of excisable products, OJ L 162/5, 1.7.2003.

<sup>10</sup> Ramboll *et al.*, 'Evaluation of Council Directive 92/83/EEC on the harmonisation of the structures of excise duties on alcohol and alcoholic beverages', June 2016.

<sup>11</sup> Commission Report (2016).

<sup>12</sup> Council Conclusions (2016).

#	Problem area	Problem outline
		fermented origin' with respect to aromatised beverages containing added alcohol as flavour-carrier, which may affect market functioning. Finally, the lack of a separate Excise Product Code (EPC) for 'other fermented beverages' may hamper monitoring and control, and a proper enforcement of the excise duty system.
2	<b>Exemptions for denatured alcohol</b>	The Directive stipulates that alcohol produced not for human consumption shall be exempted from excise duty – but in order to prevent tax fraud or evasion (i.e. to eliminate the risk that alcohol intended for other purposes is sold as potable alcohol), the alcohol has to be denatured with the addition of chemical substances. The different regulatory and supervisory frameworks in use in the MS, including the proliferation of denaturing procedures and formulations, and rules for mutual recognition that are not always clear, can create legal uncertainty, barriers to trade and additional costs for economic operators, and enforcement costs for the competent authorities in the MS.
3	<b>Reduced rates for small producers</b>	Member States have the option of granting reduced excise duty rates to small producers of beer and ethyl alcohol. This provision allow MS to support the competitiveness of small and medium-sized enterprises (SME) versus large players, in the case of beer, and to protect traditional productions, in the case of ethyl alcohol. Reduced rates, however, cannot be granted to small producers of wine, other fermented beverages, and intermediate products. This may affect conditions for competition, and it prevents MS from pursuing the same policy objectives in the markets for the excluded categories.
4	<b>Reduced rates or exemptions for low-strength alcoholic beverages</b>	For each fiscal category, the Directive sets the thresholds (in ABV) below which a product can be considered of low-alcoholic strength. MS may apply reduced rates to these products, but only a few of them have adopted this option. It is unclear if such limited uptake is due to uncertainties with the intended policy objectives, the relevance of the coverage thresholds selected, or other factors.
5	<b>Exemptions for private production</b>	Beer, wine and other fermented beverages produced by a private individual for his/her own consumption or that of his/her family and guests may be exempted from excise duty, provided that no sale is involved. The same provision, however, is not available for intermediate products and ethyl alcohol.
6	<b>Calculation of excise duties on sweetened / flavoured beer using the Plato method</b>	The Directive allows MS to calculate the excise duty on beer by reference to either the strength by volume (ABV) or the Plato degree of the finished product. While for traditional beer the methods are clear and consistent, there may be issues with the calculation of the excise duty for sweetened/flavoured beers in countries adopting the Plato method, due to diverging interpretations of the terms 'finished product'. As a consequence, the tax treatment, and hence the competitive conditions, of these products may be uneven.

## 1.3 Overview of methodology

### 1.3.1 Data collection methods

#### 1.3.1.1 In-depth consultation of stakeholders

##### ➤ THE INTERVIEW PROGRAMME

The bulk of the data collection activities was centred on an in-depth on-the-field consultation of stakeholders in several Member States and at the EU level. Overall, **161 stakeholders were consulted**, for an estimated total of over 215 individual participants (many interviews were attended by multiple participants). This largely exceeded the initial minimum target of 120 interviews. As initially envisaged, interviews were conducted in the six countries selected for core fieldwork (DE, FR, IT, PL, RO, UK), as well as in the other six MS selected for the thematic research on specific issues (AT,

BE<sup>13</sup>, CZ, ES, FI, NL). The geographical distribution of interviews is provided in Table 3 below.

With respect to the typology of informants involved in the interview programme, attention was paid to ensure an appropriate balance between different types of stakeholder and in particular:

- (i) public authorities and private sector players;
- (ii) industry representatives and public health representatives (including non-governmental organisations (NGOs) and experts);
- (iii) large players and SMEs;
- (iv) economic operators from different alcohol beverage segments (beer, wine, other fermented beverages, intermediate products, ethyl alcohol), as well as representatives of industrial alcohol producers and users (e.g. cosmetics, bioethanol and other industries).

The organisation of interviews was relatively smooth, although certain segments of the liqueurs and spirits industry required additional efforts. Overall, one-third of the entities contacted refused the interview or did not followed up. A breakdown of the interviews conducted, by type of respondent is provided in Table 3 below.

**Table 3 – Breakdown of in-depth interviews, by type of respondents and country of origin**

Respondent Type	No. of stakeholders interviewed	Country of origin	No. of stakeholders interviewed
<b>European Commission staff</b>	<b>5</b>	France	26
<b>MS Competent Authorities</b>	<b>33</b>	Germany	15
- Tax/customs authorities	21	Italy	19
- Public Health authorities	7	Poland	17
- Other (Agriculture authorities, etc.)	5	Romania	10
<b>Economic operators and trade associations</b>	<b>112*</b>	United Kingdom	14
- Beer sector	30	Austria	6
- Wine sector	34	Belgium	8
- Cider and OFB sector	33	Czech Republic	6
- Spirits and liqueurs sector	30	Finland	9
- Industrial alcohol sector	32	Netherlands	9
- Other (e.g. home brewers association, etc.)	5	Spain	4
<b>Public health NGOs</b>	<b>7</b>	Other MS**	2
<b>Others (e.g. experts etc.)</b>	<b>4</b>	EU level	16
<b>Grand total</b>	<b>161</b>	<b>Grand total</b>	<b>161</b>

**Notes:** (\*) the total for this category does not add up to the number of interviews per sector, since various interviewees operate in more than one sector; (\*\*) from MS not included in the selected sample.

All interviews were based on the checklists for discussion that were developed in the inception phase – and further refined and consolidated during the data collection phase. In various instances, the standard checklists were further customised to better address the nature of the respondent and the specific MS legal framework. The checklists were generally sent to interviewees a few days ahead of the meeting in order to allow for the preparation of the discussion. Interviews were almost entirely conducted by senior members of the team (99%), preferring face-to-face meetings (74%) over phone interviews (24%) and written consultations (2%). The average duration of interviews was of 60-90 minutes, with a few meetings lasting up to 2.5 hours.

<sup>13</sup> Belgium replaced the initially selected Estonia during the inception phase, based on considerations on its greater relevance for themes like (i) reduced rates for small producers, and (ii) the calculation of excise duties on sweetened beer using the Plato method.

Members of the study team also took part in two EU-level meetings of relevant groups of national experts:

- Meeting of the Indirect Tax Expert Group (ITEG) and the Excise Committee, on 21 March 2017, which included a discussion on the draft Commission Implementing Regulation on the procedures for completely denatured alcohol (CDA).
- Meeting of the Fiscalis Project Group (FPG) 013 on CDA, on 5 July 2017, which discussed a range of issues related to the Eurodenaturant including transitional periods and standard operating procedures (SOP).

### 1.3.1.2 Open Public Consultation

The Consultant assisted DG TAXUD in the preparation and implementation of an Open Public Consultation (OPC) aimed at gathering the views of EU citizens and stakeholders on a possible revision of the Directive.<sup>14</sup> The questionnaire included a total of 58 questions, divided into four thematic sections. The questions primarily concerned (i) the respondents' perception of the issues at stake; (ii) the agreement / disagreement with a set of possible options and approaches to the issues at stake, and (iii) the respondents' expectations about the impact that may derive from the adoption of certain measures.

In order to take into account the potentially high diversity of respondents' backgrounds, each thematic section of the OPC included general questions suitable for all type of respondents and more specific questions requiring an in-depth knowledge of (or specific interest in) the technical functioning of the Directive. Respondents were allowed to complete only the section(s) they were more interested in or familiar with and skip the other questions or even entire thematic sections. In addition to the various thematic sections, the questionnaire also included: a 'general information' section to present the background and objective of the consultation, a 'respondent's profile' section to determine the nature, origin, and eventual specific interests of the respondent, and the possibility to upload additional documents.

The English version of the OPC was launched on 18 April 2017, while the translated versions – which included all EU languages – went online around the 10 May 2017. It remained open until 11 July 2017, for a total of 12 weeks for the English version and 9 weeks for the other versions. A total of 165 valid responses were registered,<sup>15</sup> from 21 MS. The majority of respondents were industry stakeholders, with 61 economic operators (i.e. 37% of the total) and 58 industry associations and similar entities with specific interests (35%). In addition, respondents also included 37 private individuals (22%), 3 public authorities (2%), 2 public health NGOs (1%) and 6 other miscellaneous respondents (4%).

### 1.3.1.3 Desk research

**Statistics and databases.** The preparatory work for the analysis of quantitative impacts required the acquisition and systematisation of data and statistics from various sources. Several documentary sources and datasets were reviewed throughout the Study, in particular:

- **Alcoholic beverages market data.** Various market intelligence data providers were considered as possible sources of market data on alcoholic beverages. The

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<sup>14</sup>[https://ec.europa.eu/taxation\\_customs/consultations-get-involved/customs-consultations/public-consultation-structures-excise-duties-applied-alcohol-and-alcoholic-beverages\\_en](https://ec.europa.eu/taxation_customs/consultations-get-involved/customs-consultations/public-consultation-structures-excise-duties-applied-alcohol-and-alcoholic-beverages_en)

<sup>15</sup> Not including 4 completely blank responses and counting only once a response that was submitted two times by the same respondent.

Consultant compared the relative strengths and weaknesses of the main providers, based on detailed information and system previews and, in agreement with DG TAXUD, opted for the IWSR database.<sup>16</sup> The main reasons included: (i) a significant number of brand-lines covered by IWSR especially in important areas like ready-to-drink (RTD) / alcopops and medium strength liqueurs; (ii) country summaries produced by sector specialists; (iii) high granularity in the classification of beverages by sub-categories; (iv) flexibility in the customisation of the product, which enhanced the value-for-money. In the end, the data acquired include:

- Brand-line data (volume, value, price, owner, distributor, country of origin) for a total of 1,374 products, belonging to 15 subcategories deemed relevant for the Study (flavoured beers, pre-mixed cocktails, long drinks, liqueurs, flavoured alcoholic beverages, etc.), for the 12 sample MS, covering the period 1990-2016, and including forecast until 2021.<sup>17</sup>
- Top-line data (volume, value) for main categories of alcoholic beverages and for all EU28 MS, in order to analyse the scale of the above subcategories in the overall market.
- Country analytical 'profiles' for all the EU28 MS.

The IWSR is comprehensive for all the categories of products considered, with the partial exception of ciders, for which the level of granularity is lower. According to the cider industry, none of the major market intelligence companies is able to provide aggregated and robust figures on this market, with the partial exception of *Canadean* which has market overviews for the UK and a few other EU countries in its portfolio. These reports are however based on 2015 data, and no updates were foreseen during the life of the Study so it was decided not to use them.

- **Industrial alcohol market data.** For the 'denatured alcohol' case-study, data on the market of industrial alcohol (e.g. employed in cosmetics, screen-washes and detergents, biofuels etc.) was sought. In agreement with DG TAXUD, the Consultant eventually purchased the report and dataset published by the LMC International on the *European Market for Industrial & Potable Alcohol*. This source only partly satisfied the information needs, as it contains data on industrial alcohol but not on the amounts that are denatured, and not broken-down by end use in great detail. Moreover, the report is not very recent (data are from 2014). However, it nonetheless provided a useful overview of the size and the main market trends in the production, consumption and price of alcohol across the EU Member States.
- **Tax rates and revenues data.** Based on DG TAXUD's Excise Duty Tables (EDT) series, the Consultant has compiled a database with the information on how the tax rates (including reduced rates) have evolved in all EU28 MS in the 2010-2017 period, and the excise revenues trends per category of product (2008-2016 period). This information has been used in the analytical model to identify market effects induced by a variation in the excise duty and predict possible impacts of the proposed policy options. The granularity of the information was however not always optimal, since 'OFB' and 'Wine' figures are generally aggregated, and some MS provide consolidated data also for other categories of product. So, we have estimated the hypothetical tax revenue from these product categories combining EDT data with the above IWSR data, as well as figures provided directly by some MS authorities.
- **Production and consumption statistics.** Other useful indicators and statistics on the production and consumption of alcoholic beverages have been collected and processed. These include:

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<sup>16</sup> <https://www.theiwsr.com/index.aspx>

<sup>17</sup> For respect of IPR agreement no individual brand data is reported in the Study.

- Production and trade statistics published by Eurostat (Prodcum and Comext databases). Since Eurostat data is based on the NACE 2 nomenclature, the Consultant also accessed the latest version of the correspondence table between Prodcum and CN codes available in the Ramon database.
  - Consumption and heavy consumption data – by gender, age group, level of education, level of income, and degree of urbanisation – available on Eurostat.
  - The statistics on consumption of pure alcohol, also including estimates of the unrecorded consumption, elaborated and published by WHO-GISAH, and those collected by ESPAD on consumption of alcohol among young people and children.
  - Three Special Eurobarometer surveys (331 of 2010, 272b of 2007, and 186 of 2003) on the attitudes of EU citizens towards alcohol, with special reference to consumption figures by gender and age group.
  - DG AGRI's figures on the production, consumption and prices of wine.
- **European Binding Tariff Information database.** The information contained in the publicly-accessible section of the EBTI database have been downloaded and organised for further processing. The methodology presented in the Inception Report envisaged a possible linkage of the EBTI with the sales data contained in the IWSR, with the aim of estimating the possible market effects of tax treatments induced by BTI decisions and assessing the extent and frequency of disparities of treatment. However, it was not possible to obtain access to the confidential section of the database to conduct an in-depth research. So the EBTI database was used to identify possible disparities of treatment among similar products, based on a qualitative review of the general description of BTI decisions that is publicly available.

**Other documentary sources.** In addition to the above-mentioned databases, the Consultant collected and mapped over 250 additional documentary sources of various nature, primarily – but not exclusively – MS-level documents, often suggested by the counterparts met during fieldwork.<sup>18</sup> However, in some areas there is a scarcity of systematic and reliable data, and this required sometimes complex triangulation and extrapolation of information from heterogeneous sources, as well as the formulation of strong assumptions and hypothetical scenarios.

Overall, the documentary materials collected during fieldwork include:

- Relevant EU pieces of legislation and policy documents, including for instance Directives, Regulations, Judgements of the CJEU, etc.
- National legislation transposing Directive 92/83/EEC into national law and other relevant acts and laws concerning the regulation of alcoholic beverages.
- Annual reports of Tax Authorities, Finance Authorities, Customs Authorities, and Agriculture Authorities.
- Strategy documents and other programmes of Public Health Authorities on alcohol consumption control policy objectives and results.
- Industry reports on the market of alcoholic beverages (volume and value). Also position papers, studies commissioned for consultancies and other relevant materials on tax-induced effects.
- Consumer surveys and behavioural studies, including articles published by alcohol consumption control NGOs and experts.
- EU-level materials including funded research, evaluation studies, Fiscalis' outputs, previous conferences and forums outputs, etc.
- Scientific literature, media articles and other 'grey' literature etc.

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<sup>18</sup> The complete bibliography is available in the annexes.

## 1.3.2 Data analysis and judgment

### 1.3.2.1 Structuring the work

The initial phase of the Assignment was dedicated among other things to structuring the analytical framework of the Study. In addition to various preliminary data gathering activities and a stakeholder analysis, the main focus consisted of refining the two main scenarios for comparison for all the issues at stake, i.e.:

- i. The **'no change' scenario**, i.e. no amendment of the Directive. This scenario coincides with the business-as-usual situation. However, since markets evolve and MS may continue regulating the above matters at national level, the impact of the Directive would inevitably change, even if the text were not modified ('dynamic baseline').
- ii. The **'policy change scenario'**, i.e. a formal amendment of the Directive and/or non-regulatory measures. In some instances, this may introduce new provisions and norms, in others it may consist of clarifications of the existing provisions and/or other supporting measures for their proper implementation.

Firstly, this entailed conducting a problem analysis to determine the nature, relevance and magnitude of the specific issues considered. Secondly, it required a critical assessment of the policy options under consideration with a view to clarify them and to firm-up the list of those that qualified for a more in-depth impact assessment. Thirdly, it envisaged a preliminary identification of the relevant impacts that can be expected from those options, as well as of their salient features. The results of this analytical work were provided in the Inception Report.

### 1.3.2.2 Baseline analysis

The baseline analysis is an essential cornerstone of the analytical work, since it sets out the terms for comparison of the proposed policy options. The implementation of the Directive had been extensively assessed in the Ramboll Evaluation, whose findings are the basis of this Study. In the baseline analysis these findings were further investigated and in particular: (i) certain issues have been quantified (based on the evidence available); (ii) some information has been updated and verified due to evolving legal and market frameworks; and (iii) the expected trends, in the absence of policy changes, have been projected.

The implementation of the baseline analysis involved various dimensions, which varied across the issues at stake, including among other things: the tax treatment of certain products (legal and procedural provisions), the monitoring system in place in the MS, the market structure, size and trends (including consumer trends), the estimated amount of excise duty collected and possible tax 'gaps', the extent of illicit trade and of tax avoidance practices, the trends and outcomes of alcohol consumption control policies (see Table 4 below).

**Table 4 – Overview of issues for the baseline assessment across problem areas**

Problem area	Relevant issues for the dynamic baseline assessment
<b>Classification of alcoholic beverages</b>	<ul style="list-style-type: none"> <li>• Segmentation and market data analysis of 'borderline' product.</li> <li>• Review of MS <i>ad hoc</i> regulations (premises / alcopops taxes, special tax regimes for cider etc.).</li> <li>• Existence of incentives for 'borderline' products, due to tax differentials.</li> <li>• Extent of tax-induced impact on the demand (via price levels) and affordability of alcoholic beverages (as a proxy for impacts of public health relevance).</li> <li>• Estimated substitution effects across categories.</li> <li>• Frequency and cost estimates of administrative measures (e.g. BTI) and</li> </ul>

Problem area	Relevant issues for the dynamic baseline assessment
	disputes. <ul style="list-style-type: none"> <li>• Coherence with sectoral regulation, and international trade implications.</li> <li>• Market analysis of the products facing possible disparities of treatment.</li> </ul>
<b>Exemptions for denatured alcohol</b>	<ul style="list-style-type: none"> <li>• Production, use and cross-border trade in denatured alcohol.</li> <li>• National denaturing procedures and supervisory regimes and their implications for economic operators.</li> <li>• Implications of national differences for the functioning of the Single Market, including problems of mutual recognition and other trade barriers.</li> <li>• Fraud with surrogate alcohol from different sources / origins (as a proxy for impacts of public health relevance).</li> </ul>
<b>Reduced rates for small producers</b>	<ul style="list-style-type: none"> <li>• Legal framework, MS implementation and other schemes supporting small producers.</li> <li>• Industry analysis of the relevance of small producers across the five product categories (representative product).</li> <li>• Issues with functioning of the reduced rates for small breweries: (i) appropriateness of the threshold, (ii) administrative burdens and enforcement costs; (iii) legal certainty; and (iv) functioning for cross-border operators.</li> <li>• Appropriateness of the threshold for small distilleries.</li> <li>• Uneven treatment of small producers of other alcoholic beverages (wine, other fermented beverages, and intermediate products) and more limited possibility for MS to correct potential market imbalances in these markets.</li> <li>• Impact on per capita consumption (as a proxy for impacts of public health relevance).</li> </ul>
<b>Reduced rates for low-strength alcohol</b>	<ul style="list-style-type: none"> <li>• Definition of low-strength beverages across the fiscal categories, and market analysis thereof.</li> <li>• Tax impacts of reduced rates for low-strength alcohol.</li> <li>• Rationales for applying reduced rates to low-strength alcohol and effects of the current thresholds.</li> <li>• Impact on per capita consumption (as a proxy for impacts of public health relevance).</li> </ul>
<b>Exemptions for private production</b>	<ul style="list-style-type: none"> <li>• National legal frameworks for the private production of alcoholic beverages.</li> <li>• Amount of illicit private distillation.</li> <li>• Effects of private production of fermented beverages: market distortions, cross-border impacts, tax frauds, administrative burdens, enforcement efforts, health effects.</li> <li>• Effects of private distillation: foregone revenues, market distortion, cross-border impacts, tax frauds, administrative burdens, enforcement efforts, health effects.</li> <li>• Impact on per capita consumption (as a proxy for impacts of public health relevance).</li> </ul>
<b>Measurement of Plato degree for sweetened / flavoured beer</b>	<ul style="list-style-type: none"> <li>• Market and product analysis of sweetened and flavoured beer.</li> <li>• National approaches to the measurement of the Plato degree of sweetened and flavoured beer.</li> <li>• Tax revenues from sweetened and flavoured beer.</li> <li>• Impacts of different measurement approaches on tax treatment.</li> <li>• Legal disputes.</li> <li>• Impact on per capita consumption (as a proxy for impacts of public health relevance).</li> </ul>

### 1.3.2.3 Impact analysis and comparison of scenarios

The proposed policy options for the revision of the Directive may determine a variety of different economic and social impacts for various different stakeholder groups, primarily MS competent authorities and economic operators, secondarily consumers and public health stakeholders. The different typologies of impacts assessed in this Study can be gathered in five main categories, as follows:

- i. **Direct charges.** Direct charges include taxes and fees paid by economic operators or consumers. In line with the nature and scope of Directive 92/83/EEC, the focus of this Study is excise duty on alcohol and alcoholic beverages, and the related excise duty revenues of Member States. This dimension has been examined across all thematic areas considered. Unless differently stated, all references to 'tax rates', 'tax structures', 'tax revenues' etc. in this Report relate to excise duties. However, in some

cases, the analysis has also encompassed VAT, and in particular the share of VAT that is imposed on the excise duty since this causes a multiplier effects on the variation of excise duty levels.

Importantly, tax revenues have distributional impacts: what is a benefit for tax authorities may be a cost for consumers and/or manufacturers. In the assessment and comparison of policy scenarios these impacts were primarily examined from the perspective of tax authorities. In this sense an increase of tax revenues is rated positively and *vice versa*. Impacts on tax revenues can be triggered by variations of: (i) rates applicable to excisable products, which is outside the scope of the Study, with the exception of provisions on reduced rates or methods for the calculation of applicable tax; and (ii) scope of the tax system (exemptions / inclusions) and of individual tax category, with the possible re-classification of certain products in different categories. It is also worth mentioning that these variations may also trigger other impacts, considered below under market or social effects, such as tax-induced substitution between products, per capita consumption effects, demand for illicit products and fraud.

- ii. **Compliance, administrative burden, costs and cost savings.** Compliance costs have been considered with respect to the changes to business practices linked to the administrative requirements concerning denatured alcohol. Administrative burden for economic operators have been assessed in various policy options implying a revision of the Directive. For instance, the creation of a new fiscal category for certain products may generate administrative burden for economic operators, who have to update their licenses and IT systems. Another example is the quantification of the current administrative burden generated by the reduced rate scheme for small brewers, and the costs associated with its revision, or to the extension of the scheme to small wine producers and cider makers.
- iii. **Enforcement costs and benefits.** As regards enforcement costs and benefits, two main types have been considered:
  - 1) enforcement costs and cost savings *stricto sensu*, which are those borne by public authorities to apply the revised Directive provisions; and
  - 2) judicial costs and cost savings, which are costs borne by public authorities and economic operators related to the need to interpret unclear legal provisions and, in case of judicial disputes, uphold them in court, as well as benefits (cost savings) where interpretations and judicial disputes are no longer needed after a clarification or legal revision.
- iv. **Market effects.** Market effects concern distortions of the quantity exchanged and of the equilibrium price of the various products. Taxation, by definition, distorts any market from the equilibrium that it would reach based on the free adjustment of demand and supply. For this reason, the Study did not attempt to assess market distortions *per se*, but those that might go beyond the intended objectives of the regulator, in terms of Single Market functioning. Four categories of possible market effects and distortions have been considered:
  - 1) Tax-induced substitution across products, i.e. when the demand for a certain product is favoured (hampered) by the higher (lower) taxation imposed on one or more substitute products.
  - 2) Cross-border distortions and illicit markets. This may be the case when consumers decide to purchase a certain product (e.g. alcoholic beverages, denatured alcohol) in another MS, or stop importing the same product from another MS, because of the different tax or regulatory treatment. Effects on illicit (or informal) markets also include impacts from and on the quantity of 'unrecorded alcohol', i.e. alcohol which is not taxed and is outside governmental

- control. This includes cross-border shopping (both legal, and smuggling / 'bootlegging') and, most importantly for the policy issues considered, surrogate products obtained from previously denatured alcohol and home production.
- 3) Single Market functioning, and possible distortions induced by diverging legal treatments or uneven application of Directive provisions or other administrative obstacles hampering the circulation of products or affecting fair competition.
  - 4) SME competitiveness, since certain impact may have a differential effects on small producers versus large manufacturers. This is specifically the case for the analysis of the 'reduced rates for small producers' issue, where both the baseline assessment and the impact analysis consider whether and to what extent the norms at stake change the competitive position of SME.
- v. **Indirect social effects.** This category includes impacts that poorly lend themselves to a quantification in monetary terms, but are nonetheless important since they concern the underlying values and principles of policy action that are linked to social well-being in the broad sense. Two areas of social impact that have been considered related to the policy options at stake - although indirectly - are namely: (i) public health (through alcohol control policy and measures); and (ii) tax fraud.

The final step of the analysis of impacts consisted of the **comparison of the policy options**. The issues at stake in this Study require policy revisions that are relatively independent from one another. Therefore, the comparison of options have been performed for each thematic area separately, rather than in a cumulative way. Given the different nature of the impacts considered, the final comparisons required combining different approaches, and specifically, a partial cost-benefits analysis (CBA) approach for quantifiable (monetary) impacts, such as market effects, tax revenues and – where feasible – regulatory costs, and a multi-criteria analysis (MCA) for non-quantifiable or mixed ones.

## 1.4 Structure of the Report

The Report is divided in two volumes: **Volume 1 – Main Text**, and **Volume 2 – Annexes**. The rest of Volume 1 includes three Sections, whose structure follows a cross-thematic approach, meaning that every Section is further subdivided into six parts, each one focusing on one of the issues at stake (see Table 2 above). The three Sections include the following:

- **Section 2** deals with the problem analysis and provides a dynamic baseline assessment of the six identified problem areas (and the relative issues at stake), including both a discussion of the current situation and an analysis of the expected evolution in the absence of any Commission intervention.
- **Section 3** defines the various policy options identified to address the issues at stake, analysing the nature and – whenever possible – the magnitude of the respective positive and negative impacts they would have.
- **Section 4** compares the various impacts expected from both the dynamic baseline scenario and the identified policy options, leading to a final set of conclusions.

## 2 ANALYSIS OF THE ISSUES AT STAKE

### 2.1 Classification of alcoholic beverages

#### 2.1.1 Background and structure of this Section

##### ➤ BACKGROUND OF THE CLASSIFICATION ISSUE

The evaluation of Directive 92/83/EEC conducted in 2016 by *Ramboll et al.* under the REFIT Programme<sup>19</sup> provided a generally positive appreciation of the functioning and effectiveness of the Directive, with the main exception of some classification issues concerning certain categories of products. In the Staff Working Document accompanying the Commission Report<sup>20</sup> on the evaluation of the Directive, the classification-related issues are articulated as follows<sup>21</sup>:

- There are different MS interpretations of the meaning of the 'entirely of fermented origin' provision, leading to disparities of treatment of the same product across different national markets.
- The differential between the tax treatment of different categories of product may create incentives to develop and market 'borderline' products exploiting classification ambiguities to obtain favourable treatment and circumvent what was arguably the intention of the legislator.
- The issue of classification of these types of products may be significant in terms of the potential revenue loss, with potentially hundreds of millions of Euros of tax revenue at stake per annum.
- The track-record of disputes related to the classification of certain alcoholic beverages may show that the intention of the legislator is not being interpreted coherently across the EU, with potential consequences in terms of legal certainty, competition and the overall functioning of the internal market.

According to the Commission Report, excise classification issues relate primarily to uncertainties in the customs classification of certain products and, in particular, to the application of codes 2206 and 2208 of the Combined Nomenclature.<sup>22</sup> The Commission Report also notes that the attempts to resolve excise classification issues through legal interpretation of the CN codes - i.e. the CJEU jurisprudence - have not proved effective so far.

On this basis, in December 2016 the Council adopted a series of Conclusions giving the Commission the mandate to consider amending the Directive to eliminate certain ambiguities and distortions in the tax treatment of particular types of alcohol and alcoholic beverages. The expected benefits may also include the collection of excise duties and the reduction of administrative burden for both economic operators and tax administrations in Member States. In particular, the Council Conclusions state:

- the need to clarify and to harmonise further the classification rules for products manufactured as mixtures of different categories of alcoholic beverages or as mixtures of alcoholic beverages with non-alcoholic beverages in order to unify the treatment for excise purposes of the same products across the Member States, and so ensure legal certainty and clarity for economic operators;

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<sup>19</sup> Ramboll Evaluation (2016).

<sup>20</sup> COM(2016) 676 Final.

<sup>21</sup> SWD(2016) 336 Final. Author's summary of the issues at stake.

<sup>22</sup> Respectively defined as: 'Other fermented beverages (for example, cider, perry, mead, sake); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included', and 'Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80% vol; spirits, liqueurs and other spirituous beverages'.

- the need to ensure uniform treatment of alcoholic beverages, which are the mixture of fermented beverages and alcohol, and in this context, for the purposes of legal certainty, to clarify the notion of 'entirely of fermented origin' in Directive 92/83/EEC.<sup>23</sup>

In the same vein, the Commission's Inception Impact Assessment for a proposed revision of Directive 92/83/EEC recognises that: *'the product categories as currently defined in the Directive are incomplete, leading to tax incentives being exploited by manufacturers of certain alcoholic beverages'* and therefore envisages *'to redefine the category of 'other fermented beverages' and the term "entirely of fermented origin"'*.<sup>24</sup>

#### ➤ **STRUCTURE OF THIS SECTION**

Before assessing the nature and magnitude of the 'classification' issue it is necessary to properly describe the terms and the origins of the problem, with reference to the different and incoherent definitions and classifications of alcoholic beverages that exist (Section 2.1.2) and the origin and nature of the legal (and market) issues that occurred in the past (Section 2.1.3).

Once the context of the problem is defined, a baseline assessment is conducted (Section 2.1.4) including: (i) the identification and definition of the 'problematic' products; (ii) an assessment of their market size and trends; and (iii) a review of the fiscal treatment and regulatory measures adopted at national and supranational level to deal with certain products, and the tax revenue at stake.

Finally, Section 2.1.5 outlines the features of the three 'policy problems' identified, analysing causes, drivers and adverse effects, i.e.: legal uncertainties, administrative burden, market distortion, foregone tax revenues, and possible impact on public health objectives. The analysis is preceded by a general assessment of the dynamics prevailing in the alcoholic beverage market, in particular: cross-product substitution, the impact of taxes on demand, affordability and per capita consumption.

### **2.1.2 Definition and classification of alcohol and alcoholic beverages**

Alcoholic beverages are defined and categorised at multiple levels and for different purposes. These different layers only partly coincide and this lack of coherence seems to be the single most important cause of all further classification issues analysed here. Four main dimensions exist and are considered in this Report:

- (i) sectoral legislation and established practices;
- (ii) customs classification;
- (iii) excise duty classification;
- (iv) commercial and other non-standardised classifications.

#### ➤ **SECTORAL LEGISLATION AND ESTABLISHED PRACTICES**

Most of alcoholic beverages are subject to sectoral regulation and administrative procedures, which define among other things common rules for the definition, denomination (including protected designation of origin – PDO and protected geographical indication – PGI), labelling, admitted practices etc. of products and production processes. EU-level sectoral regulation exists for wine, including aromatised

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<sup>23</sup> Council Conclusions (2016).

<sup>24</sup> IIA (2017).

wine, and spirits (see Table 5 below). Beer is instead mostly regulated within broader agriculture frameworks, while currently there is no EU-level definition of cider and other fermented beverages. In this respect, there is an ongoing initiative promoted by cider-makers and their trade associations aimed at establishing common legal definitions for cider, perry, and other fruit wines.

The sales and consumption of alcohol and alcoholic beverages is also subject to various national and EU rules and policies on prevention and control of alcohol-related health and social risks. Even if this dimension is not at the core of the classification issue discussed in this Study, it is important to consider that health-related concerns are at the basis of national measures, like the 'alcopop' taxes, aimed at restricting the access of consumers, especially young people, to certain products. As discussed further below, this raised non-trivial questions on how to define 'alcopops' and the target products in general.<sup>25</sup>

**Table 5 - Overview of relevant EU sectoral legislation and policies (non-exhaustive)<sup>26</sup>**

Sector/ theme	Legislation/documents	Subject matter
Wine	<b>Regulation (EU) 1308/2013</b>	Basic regulation - establishing a common organisation of the markets (CMO) in agricultural products.
	<b>Regulation (EU) 251/2014<sup>27</sup></b> (upcoming delegated act on production practices)	Definition, description, presentation, labelling and the protection of geographical indications of aromatised wine products.
	<b>Commission Regulation No 606/2009</b> (implementing Council Regulation 479/2008 on CMO in wine)	Oenological practices and restrictions. Designations of origin and geographical indications. Protection and control.
Beer <sup>28</sup>	<b>Regulation (EU) No 1151/2012</b> (and Implementing Regulation No 668/2014)	General framework, defining quality schemes for agricultural products and foodstuffs, including beer. Rules for the description of the product and production method. Proof of origin.
	<b>Commission Regulation 470/2012, 471/2012, and 505/2014</b> amending Annex II to Regulation No 1333/2008	Regulations regarding the use of specific ingredients in beer.
Spirits	<b>Regulation (EU) 110/2008</b>	Definition of spirit drinks. Origin of ethyl alcohol. Geographical indications.
Public health related policies	Communication to support Member State in reducing alcohol related harm <b>COM/2006/0625 final</b>	Protect young people. Reduce injuries and deaths. Prevent alcohol-related harm. Inform, educate, and raise awareness.
	<b>Action Plan on Youth Drinking</b> and Heavy Episodic Drinking by the CNAPA	Reduce heavy episodic drinking. Reduce accessibility & availability of alcohol. Reduce exposure to alcohol marketing.
	Recommendation on the drinking of alcohol by young people, in particular children and adolescents ( <b>2001/458/EC</b> ) Draft Council Conclusions on 'An <b>EU strategy on the reduction of alcohol related harm</b> ', December 2015	Producers should not target young people. Educate young people. Increase involvement of young people. Reduce alcohol-related harm.

<sup>25</sup> With respect to the definition of 'alcopop' it is worth citing the Commission latest Report on Regulation (EU) No 1169/2011: 'On the basis of the information reviewed, the Commission has not identified objective grounds that would justify the absence of information on ingredients and nutrition information on alcoholic beverages or a differentiated treatment for some alcoholic beverages, such as "alcopops". At this stage, the Commission therefore sees no need or clear added value for a specific definition of "alcopops" for labelling purposes.' Source: COM(2017) 58 final. Report from the Commission to the European Parliament and the Council regarding the mandatory labelling of the list of ingredients and the nutrition declaration of alcoholic beverages.

<sup>26</sup> Notably, the Table does not display General Food Law (Reg. 178/2002) and other legislation applicable to alcoholic beverages on e.g. labelling, nutrition, food additives, packaging etc. that are not relevant to the subject of this Section.

<sup>27</sup> Regulation (EU) No 251/2014 of the European Parliament and of the Council of 26 February 2014 on the definition, description, presentation, labelling and the protection of geographical indications of aromatised wine products and repealing Council Regulation (EEC) No 1601/91, OJ L 84, 20.3.2014. Hereinafter: 'Regulation 251/2014'.

<sup>28</sup> There is no EU-level product definition for beer. The overall acquis on agricultural products apply.

The EU-level framework is complemented by abundant national-level rules and industry-level codes of practices covering especially, but not exclusively, PDO/PGI (Protected Designation of Origin/Protected Geographical Indication) and locally-relevant products. In the case of wine and spirituous beverages of vitivinicultural origin, this is supplemented by the supranational rules, definitions and guidelines established within the International Organisation of Vine and Wine (OIV).<sup>29</sup>

The harmonised definitions, accepted practices and denominations adopted at a supranational are relevant for international trade.<sup>30</sup> This is an important component of the EU external trade: in 2016, the value of alcoholic beverages trade from/to the EU amounted to an overall EUR 24 billion (export) and EUR 4.5 billion (import), with wine accounting for 41% and 58% of the respective totals.<sup>31</sup> To facilitate trade, the EU has signed numerous agreements and treaties with international partners (e.g. OIV)<sup>32</sup> and third countries, especially on wine and in a few cases covering also spirits (e.g. Canada). A few examples of bilateral trade agreements (BTA) include, for instance: (i) USA (2006), (ii) Australia (2008); (iii) Canada (2004); (iv) Chile (2002); (v) South Africa (2002).<sup>33</sup> An important aspect of BTAs is the definition of wine and the oenological practices permitted. The external partner countries do not necessarily have the same rules as the EU, and the product definitions may slightly change across BTAs. In some cases, this may lead to products formally imported or exported as 'wine' but released on the market with a different denomination. The matter is delicate, since the lack of mutual recognition may eventually cause barriers to trade and disputes at WTO level, although so far it has seldom occurred.<sup>34</sup>

The sectoral classification is also relevant for the statistics and monitoring data on the production of manufactured goods. To this end, the Eurostat's Prodcom attributes an 8-digit code<sup>35</sup> to the different types of manufactured products, which may or may not correspond to the Combined Nomenclature (CN) codes (see below). For alcohol and alcoholic beverages, 20 different Prodcom codes are defined, corresponding to 171 different CN codes. The correspondence is univocal: Prodcom codes may aggregate more CN codes, but each CN code corresponds to only one Prodcom code.

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<sup>29</sup> In particular: OIV, International Code of Oenological Practices, 2016 Issue. This work constitutes the technical and legal reference document for the standardisation of products of the vitivinicultural sector, and it is intended for the establishment of national or supranational regulations and the international trade.

<sup>30</sup> While the official classification for trading purposes is the customs classification (see next point), the OIV and other sectoral legislation remains important to define the denomination and the characteristics of specific products in a more detailed manner.

<sup>31</sup> Source: Comext.

<sup>32</sup> See for instance, the recent 'Commission Proposal for a Council Decision establishing the position to be adopted on behalf of the European Union with regard to certain resolutions to be voted in the framework of the International Organisation for Vine and Wine (OIV)', COM(2016) 579 final

<sup>33</sup> A full list of bilateral agreements with third countries established by the European Commission is available at: [https://ec.europa.eu/agriculture/wine/third-countries\\_en](https://ec.europa.eu/agriculture/wine/third-countries_en)

<sup>34</sup> Only one WTO case is known in this area: in 2002, Argentina requested consultations with the EC regarding several EC regulations and other mandatory provisions on oenological practices and on trade in wine. Argentina's complaint was in respect of Council Regulation (EC) No. 1493/1999 and Commission Regulation (EC) No. 883/2001, which relate to the administration and the common organisation of the market in wine, the establishment of authorised oenological practices and the regulation of trade between the countries of the EU and third countries.

Source: [https://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds263\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds263_e.htm)

A few other WTO disputes involving the EU on alcoholic beverages issues regarded special fees and other discriminatory measures, but did not directly concern the definition or classification of products.

<sup>35</sup> The first four digits are drawn from the Statistical Classification of Economic Activities in the European Community (NACE).

➤ **CUSTOMS CLASSIFICATION**

The relevant classification for trading purposes of alcohol and alcoholic beverages is the customs classification. Laid down in the Combined Nomenclature (CN)<sup>36</sup> - a further development of the Harmonized System (HS) nomenclature of the World Customs Organization (WCO)<sup>37</sup> - this classification is used to determine the applicable tariff ('tarification') to goods declared to customs in the EU. As discussed further below, the CN classification determines also the excise duty category of products and is therefore at the core of the 'classification issue' described in this Section.

CN codes have (on CN level) 8-digits. The first 4-digits are the most important, since they define the product 'heading' and are relevant for the determination of the excise duty. In a few cases, however, the tax categorisation of certain products make reference to 6-digit or 8-digit sub-headings (e.g. for sparkling wine and other fermented beverages). As of the latest revision<sup>38</sup>, the customs classification included an overall 180 8-digit sub-headings clustered into six main headings as in Table 6 below.

**Table 6 – Structure of the HS/CN classification of alcohol and alcoholic beverages**

<b>CN / HS headings (4 digits)</b>	<b>6-digit<sup>39</sup></b>	<b>8-digit</b>
<b>2203</b> Beer made from malt.	none	<b>3</b> subheadings
<b>2204</b> Wine of fresh grapes, including fortified wines; grape must other than that of heading 2009.	<b>5</b> subheadings	<b>126</b> subheadings
<b>2205</b> Vermouth and other wine of fresh grapes flavoured with plants or aromatic substances.	<b>2</b> subheadings	<b>4</b> subheadings
<b>2206</b> 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.	none	7 subheadings
<b>2207</b> Undenatured ethyl alcohol of an alcoholic strength by volume of 80% vol or higher; ethyl alcohol and other spirits, denatured, of any strength.	none	<b>2</b> subheadings
<b>2208</b> Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80% vol; spirits, liqueurs and other spirituous beverages.	<b>7</b> subheadings	<b>54</b> subheadings

The CN, and its parent HS, are closed systems designed to comprehend all traded products, so each heading includes one or more residual 'other' category(ies) to cover products not explicitly mentioned in the definitions. This entails that new products not strictly matching the definitions provided should in any case fit into one of the existing CN codes. To facilitate coding, the CN (and the HS) is underpinned by non-binding Explanatory Notes (CNEN), which are revised and adjusted periodically.

For legal certainty on the correct 'tarification' of beverages, and to prevent the risk that the attribution of a certain CN code is challenged (and fined) by customs or tax authorities when the product is already commercialised, economic operators may apply for a Binding Tariff Information (BTI). These are classification decisions issued by the customs administration of any Member State, which are binding throughout the EU for a period of normally three years (unless the classification code changes or it is affected by EU or international customs tariff measures or by a CJEU judgement). For products of dubious classification, such as certain new products, BTIs represent a practical solution to avoid disparities of treatment and ensuing disputes with customs authorities. However, since the tax classification is determined by the CN code, BTIs may also become a source of controversy between countries. Economic operators may be tempted

<sup>36</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2016:294:TOC>

<sup>37</sup> See <http://www.wcoomd.org/en/topics/nomenclature/instrument-and-tools/hs-nomenclature-2017-edition.aspx>

<sup>38</sup> Commission implementing regulation (EU) 2016/1821 of 6 October 2016 amending Annex I to Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff, OJ L 294, 28.10.2016.

<sup>39</sup> Until the 6-digit level the CN and the HS codes coincide.

to request a BTI in jurisdictions where it is more likely to obtain a more favourable (tax-wise) classification, in order to get competitive advantages across all EU national markets.

According to the database maintained by DG TAXUD, there are 1,025 alcoholic beverages in the EU that are covered by a BTI decision.<sup>40</sup> Of course, BTIs do not only address products that intend to obtain a more favourable treatment, however a cursory analysis of the distribution across CN subheadings (Table 7) may provide a first hint of the areas where classification ambiguities prevail. In particular:

- Other fermented beverages, other than cider and perry (CN 2206 0039 and CN 2206 0059), alone account for a quarter of all BTIs, nearly as many as beer, wine and all other fermented beverages altogether.
- There are also frequent BTIs in the area of aromatised wine product (AWP)<sup>41</sup> below 18% vol (CN 2205 1010), which is another area of accelerated innovation.
- The high concentration of BTIs in categories like other spirituous beverages (CN 2208 9069) and liqueurs and cordials (CN 2208 7010) may be partly explained by borderline products, e.g. certain 'mixed drinks' that did not manage to obtain a more favourable CN 2206 classification.

**Table 7 – Distribution of BTIs across CN codes and EU countries**

CN Heading and Sub-heading	No. of BTI	Most Frequent MS of emission
All Beer (2203)	75	DE, UK
All Wine (2204)	66	DE, FR
Flavoured wine < 18% vol (2205 1010)	81	IT, FR
Rest of flavoured wine (2205)	15	FR, UK
OFB, sparkling other (2206 0039)	89	UK, FI
OFB, still other (2206 0059)	163	FR, DE, PT, UK, FI
Rest of OFB (2206)	55	UK, FR
Ethyl alcohol > 80% (2207)	61	NL, CZ
Liqueurs and cordials (2208 7010)	64	IT, IE
Other spirituous beverages (2208 9069)	258	FR, UK, CZ, SK, EE
Rest of Ethyl alcohol < 80% (2208)	98	FR, FI, DE

**Source:** Author's analysis of EBTI database (accessed in February 2017).

**Note:** The CN codes reported in this Table relate to the latest version, i.e. Impl. Reg. 2016/1821.

There have been cases where disparities in the interpretation of the CN classification prompted the issuance of a normative act that eventually repealed existing BTIs on certain products. In particular, this was the case with Regulation 1967/2005, which ruled that a certain beer product flavoured with tequila should be considered beer as defined under CN 2203.<sup>42</sup>

#### ➤ EXCISE DUTY CLASSIFICATION

The excise duty classification is determined by the harmonised definitions laid down in Directive 92/83/EEC. According to Article 26 of the Directive, reference should be made

<sup>40</sup> DG TAXUD, European Binding Tariff Information database, available at:

[http://ec.europa.eu/taxation\\_customs/dds2/ebti/ebti\\_consultation.jsp?Lang=en](http://ec.europa.eu/taxation_customs/dds2/ebti/ebti_consultation.jsp?Lang=en), last accessed on 02 May 2017.

<sup>41</sup> In this Report, 'aromatised wine products' (abbreviated as AWP) refer generically to any kind of such products, including the three main subcategories laid down in Regulation (EU) No 251/2014: (1) aromatised wines; (2) aromatised wine-based drinks; and (3) aromatised wine-product cocktails (see Article 3 for the respective definitions). In practice, subcategory (1) is of little relevance for our analysis, and references to 'AWP' should be interpreted as primarily referred to subcategories (2) and (3) (sometimes made explicit in the text). It is important to highlight that our analysis focuses on fiscal classification of products and not to sectoral classification (as it is the case with Regulation 251/2014), so in our understanding 'AWP' includes all products that may be taxed accordingly, irrespectively of the 'blurred' boundaries between the product definitions established in Regulation 251/2014.

<sup>42</sup> Commission Regulation (EC) No 1967/2005 of 1 December 2005 concerning the classification of certain goods in the Combined Nomenclature, OJ L 316, 2.12.2005.

to the CN 'version' in force at the time of adoption, i.e. Regulation 2587/91.<sup>43</sup> However, as discussed above, the CN codes and the related explanatory notes are periodically revised. So Regulation 2587/91 is no longer in force, replaced by more recent ones (the latest being Commission Implementing Regulation 2016/1821). In this sense, the Directive contains references to CN codes that are, in principle, outdated. The issue was analysed in the Ramboll Evaluation, which concluded that it is not a source of practical problems and primarily a purely administrative issue (see Box 1 below). For this reason, and in agreement with the Commission, this matter is not in the scope of this Study.

**Box 1 – Article 26 of the Directive and the issue of references to outdated CN codes**

Article 26 establishes that the references to CN codes contained in the Directive relate to the version in force at the time of adoption, i.e. Regulation 2587/91. However, since Regulation 2587/91 is no longer in force, repealed by more recent version of the Combined Nomenclature (the latest being Commission Implementing Regulation 2016/1821), this means that the Directive contains references to CN codes that are, in principle, outdated.

On a closer look, the issue regards only two 8-digit CN codes no longer in use since recent versions of the nomenclature introduced further sub-headings. As shown in the excerpt reproduced in Table 8 below, there is no textual difference in the definition / description of the sub-heading in the two versions. The only difference lays in the fact that in Regulation 2016/1821 the numerical code is no longer mentioned. All other CN codes cited in the Directive are still valid today.

**Table 8 – Comparison between outdated and updated versions of the CN codes**

Commission Regulation 2587/91		Commission Implementing Reg. 2016/1821	
2204 21 <b>2204 21 10</b>	– Other wine; grape must with fermentation prevented or arrested by the addition of alcohol : -- In containers holding 2 litres or less : -- Wine other than that referred to in subheading 2204 10 in bottles with 'mushroom' stoppers held in place by ties or fastenings; wine otherwise put up with an excess pressure due to carbon dioxide in solution of not less than 1 bar but less than 3 bar, measured at a temperature of 20 °C	2204 21	– Other wine; grape must with fermentation prevented or arrested by the addition of alcohol: -- In containers holding 2 litres or less: --- Wine, other than that referred to in subheading 2204 10, in bottles with 'mushroom' stoppers held in place by ties or fastenings; wine, otherwise put up, with an excess pressure due to carbon dioxide in solution of not less than 1 bar but less than 3 bar, measured at a temperature of 20 °C.
2206 00 2206 00 10 <b>2206 00 91</b>	<b>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 :</b> – Piquette ..... – Other : -- Sparkling .....	2206 00 2206 00 10	Other fermented beverages (for example, cider, perry, mead, saké); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included: – Piquette ..... – Other: -- Sparkling:

In theory, legal references to CN codes no longer in force may cause incongruences and uncertainties, but since the definitions have not changed there is no tangible consequences in using the outdated or the updated nomenclature version for the purpose of tax categorisation, in particular there is no risk that a product imported using a 'new' CN code could not be identified for excise duty purposes. Some CNEN have changed over time, but since CNEN are not legally binding (and are not explicitly mentioned in Article 26) they cannot fuel legal issues in the excise duty classification of the concerned products.

The matter was explicitly addressed in the Ramboll Evaluation, in particular:<sup>44</sup>

- According to Ramboll 'these outdated references in the Directive were not reported by the stakeholders as a source of problems.' (p. 116), and 'there are no major, immediate and urgent negative consequences stemming from the reported inconsistencies' (p.141). The results of our interviews confirm this conclusion.
- Ramboll recommends to address this point in the next revision of Directive 92/83/EC. For the Commission this recommendation 'concerns minor technical changes' and is about 'outdated references / good housekeeping', i.e.: no relevant impact is envisaged (source: Commission Report to the Council COM(2016) 676 final).

The five categories established in the Directive (see Table 9) are defined primarily with reference to CN 4-digits headings but the classification structure is partly different. In particular, there is no separate tax category for vermouth and other flavoured wine (like

<sup>43</sup> Ibid.

<sup>44</sup> Ramboll, 2016.

CN 2205) and there is only one category for ethyl alcohol including spirits instead of two – CN 2207 and CN 2208. On the other hand, the excise duty classification contains the 'intermediate products' (IP) category that is not present in the CN classification. The tax and customs classifications differ also at a more granular level, and the result is that each tax category of Directive 92/83/EEC may comprise of products that fall under multiple CN headings (see Table 10).

A second important difference is that, unlike the CN classification, all tax categories are defined with reference to an explicit minimum and maximum alcohol strength, beyond which a product may change category, regardless of its nature. For instance, any fermented or mixed beverage, including wine, beer and cider, above 22% vol is taxed as 'ethyl alcohol'. The harmonised tax categories may also contain reference to specific characteristics of the products, although not systematically (e.g. reference to the entire fermented origin of the beverage, enrichment etc.).

**Table 9 – The five excise duty categories of alcohol and alcoholic beverages (Directive 92/83/EEC)**

Category	Definition
<b>Beer</b> (Article 2)	Any product falling within <b>CN code 2203</b> or any product containing a mixture of beer with non-alcoholic drinks falling within <b>CN code 2206</b> , in either case with an actual alcoholic strength by volume exceeding <b>0.5% vol</b> .
<b>Wine</b> (Article 8)	<u>Still Wine</u> : (Paragraph 1) All products falling within <b>CN codes 2204</b> and <b>2205</b> , except sparkling wine as defined in paragraph 2: – having an actual alcoholic strength by volume exceeding <b>1.2 % vol</b> but not exceeding <b>15 % vol</b> , provided that the alcohol contained in the finished product is <b>entirely of fermented origin</b> , – having an actual alcoholic strength by volume exceeding <b>15 % vol</b> and not exceeding <b>18 % vol</b> provided they have been produced <b>without any enrichment</b> and that the alcohol contained in the finished product is <b>entirely of fermented origin</b> .
	<u>Sparkling Wine</u> (Paragraph 2) All products falling within <b>CN codes 2204 10, 2204 21 10, 2204 29 10</b> and <b>2205</b> : – are contained in bottles with ' <b>mushroom stoppers</b> ' held in place by ties or fastenings, or they have an excess pressure due to carbon dioxide in solution of <b>three bar or more</b> , – have an actual alcoholic strength by volume exceeding <b>1.2 % vol</b> but not exceeding <b>15 % vol</b> , provided that the alcohol contained in the finished product is <b>entirely of fermented origin</b> .
<b>Fermented Beverages other than Wine and Beer (OFB)</b> (Article 12)	<u>Still OFB</u> (Paragraph 1) All products falling within <b>CN codes 2204</b> and <b>2205</b> but not mentioned in Article 8 above, and products falling within <b>CN code 2206</b> , except other sparkling fermented beverages as defined in point 2 of this Article and any product covered by Article 2: – having an actual alcoholic strength by volume exceeding <b>1.2 % vol</b> but not exceeding <b>10 % vol</b> , – having an actual alcoholic strength by volume exceeding <b>10%</b> but not exceeding <b>15 % vol</b> , provided that the alcohol contained in the product is <b>entirely of fermented origin</b> .
	<u>Sparkling OFB</u> (Paragraph 2) All products falling within <b>CN code 2206 00 91</b> as well as products falling within <b>CN codes 2204 10, 2204 21 10, 2204 29 10</b> and <b>2205</b> not mentioned in Article 8 above which: – are contained in bottles with ' <b>mushroom stoppers</b> ' held in place by ties or fastenings, or they have an excess pressure due to carbon dioxide in solution of <b>three bar or more</b> , – have an actual alcoholic strength by volume exceeding <b>1.2 % vol</b> , but not exceeding <b>13 % vol</b> , – have an actual alcoholic strength by volume exceeding <b>13%</b> , but not exceeding <b>15 % vol</b> , provided that the alcohol contained in the product is <b>entirely of fermented origin</b> .
<b>Intermediate Products (IP)</b> (Article 17)	All products of an actual alcoholic strength by volume exceeding <b>1.2% vol</b> , but not exceeding <b>22 % vol</b> and falling within <b>CN codes 2204, 2205</b> and <b>2206</b> but not covered by Articles 2, 8 and 12.  2. Notwithstanding the provisions of Article 12, Member States may treat as an intermediate product any still fermented beverage falling within the scope of Article 12 (1) which has an actual alcoholic strength exceeding <b>5.5 % vol</b> and which is <b>not entirely of fermented origin</b> , and any sparkling fermented beverage falling within the scope of Article 12 (2) which has an actual alcoholic strength exceeding <b>8.5 vol</b> . and which is <b>not entirely of fermented origin</b> .

<b>Ethyl Alcohol (ET)</b> (Article 20)	<ul style="list-style-type: none"> <li>– all products with an actual alcoholic strength by volume exceeding <b>1,2%</b> volume which fall within <b>CN codes 2207</b> and <b>2208</b>, even when those products form part of a product which falls within another chapter of the CN,</li> <li>– products of <b>CN codes 2204, 2205</b> and <b>2206</b> which have an actual alcoholic strength by volume exceeding <b>22 % vol</b>,</li> <li>– potable <b>spirits containing</b> products, whether in solution or not.</li> </ul>
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**Source:** Author's elaboration of Directive 92/83/EEC.

The misalignment between the CN and the excise duty classifications may cause a certain degree of complexity in the categorisation of certain products. For example, an aromatised wine product (AWP) coded CN 2205 may be taxed according to three different categories, i.e. Articles 8, 12 or 17 depending on the addition of alcohol, the overall strength, and its specific denomination. Similarly, a 'mixed drink' may be subject to Articles 12, 17 or 20 depending, again, on the alcohol origin and blend, the strength, and other factors.

For the purpose of movement and monitoring within the EU, excise goods are given a harmonised Excise Product Code (EPC). The EPC are based on the tax categories described above, but do not fully comply with them. In particular, in the EPC system wine and OFB are merged (the distinction between still and sparkling products is maintained), which may be a source of ambiguity (discussed in Section 2.1.5.3). Secondly, ethyl alcohol and spirits falling under Article 20 are split into four EPC, as follows:

- B000 - Beer;
- W200 - Still wine and still fermented beverages other than wine and beer;
- W300 - Sparkling wine and sparkling fermented beverages other than wine and beer;
- I000 - Intermediate products;
- S200 - Spirituous beverages;
- S300 - Ethyl alcohol;
- S400 - Partially denatured alcohol;
- S500 - Other products containing ethyl alcohol.

For the reasons described above, the correspondence between EPC and CN codes is 'many-to-many' i.e. there can be several CN codes for the same Excise Product Code or *vice versa*.<sup>45</sup> Table 10 below summarises the possible correspondences (not exhaustive) between the two systems, highlighting the cases where multiple correspondences are possible. In most cases, the correspondence is straightforward, nonetheless it is interesting to note that beverages under CN 2206 00 39 ('other sparkling OFB') may correspond to five different EPC, and similar degree of ambiguity can be found with various other CN 2206 products and – to a lesser extent – CN 2205 and CN 2204 products.

**Table 10 – The multiple correspondences between CN and EPC<sup>46</sup>**

CN headings / subheadings	Excise product codes						
	B000	W200	W300	I000	S200	S300	S400
2203	X						
2204 10 and 2204 29 10			X				
2204 21 06 - 2204 21 09		X	X				
2204 21 11 - 2204 21 84 and 2204 29 11 - 2204 29 84 and 2204 30		X					
2204 21 85 - 2204 21 91 and 2204 29 85 - 2204 29 91 and		X		X			

<sup>45</sup> DG TAXUD, 'Functional Excise System Specifications (FESS)', version 3.65-EN, 16.09.2014.

<sup>46</sup> EPC S500 is not displayed since it refers to products that does not fall in the CN 22 Chapter's Headings for alcoholic beverages and spirits that are relevant in this Study.

CN headings / subheadings	Excise product codes						
	B000	W200	W300	I000	S200	S300	S400
2204 21 86 - 2204 21 91							
2204 21 92 and 2204 29 92					X		
2204 21 93 - 2204 21 98 and 2204 29 93 - 2204 29 98		X		X	X		
2205 10 10 and 2205 90 10		X	X	X			
2205 10 90 and 2205 90 90				X	X		
2206 00 10 and 2206 00 51 and 2206 00 81		X		X	X		
2206 00 31		X	X	X	X		
2206 00 39	X	X	X	X	X		
2206 00 59 and 2206 00 89	X	X		X	X		
2207 10						X	
2207 20							X
2208 20 - 2208 70 and 2208 90 11 - 2208 90 78					X		
2208 90 91						X	
2208 90 99						X	

**Source:** Author's elaboration of FESS-Appendix B.

**Note:** CN headings / subheadings as in Regulation 2016/1821.

Finally, it is worth highlighting that the EU-level tax classification rules are sometimes complemented by national-level rules. These may regard the establishment of non-harmonised taxes for specific categories of products like the so-called 'pre-mix' or 'alcopop' tax in FR and DE; or MS-level distinctions within harmonised categories, such as the Romanian differentiation between cider & perry and other OFBs; or additional levies for products above a certain strength, etc. These specificities are based on domestic definition and criteria that add up to the harmonised ones and may create additional fiscal sub-categories that are relevant only locally.

#### ➤ OTHER COMMERCIAL AND NON-STANDARDISED CLASSIFICATIONS

The legal and administrative definitions and classifications described above do not necessarily correspond with the product denomination used by consumers and/or the taxonomies used by industry and market analysts to segment among the different classes of products. There is no reference standard in this area and the classifications used for commercial purposes may vary significantly depending on national contexts and classification needs (e.g. to segment by end-use, by brand quality, by production process, etc.).

In this Study, we have chosen the IWSR database as the main source of market data. This database distinguishes the product categories at four level of depth (see Table 11 below). At the highest level, there is a good correspondence between the IWSR database and the legal classification of products. However, more granular IWSR categories seldom correspond to legal ones, except where the products are defined in the sectoral legislation (e.g. PDO / PGIs). In the case of mixed drinks and new products in general, the commercial taxonomy becomes blurred, and the correspondence with legal and administrative classifications is uncertain. For this reason, the quantitative analysis carried out in this Study required a meticulous re-classification of several IWSR classes of products into formal customs and tax categories.<sup>47</sup>

<sup>47</sup> Inevitably, this entails a certain degree of uncertainty and the need to formulate assumptions and 'educated guesses' on certain niche products.

**Table 11 – The IWSR classification of alcoholic beverages**

<b>IWSR Classification (4 levels)</b>	
<b>Beer</b>	<b>Spirits</b>
Flavoured Beer	Agave-Based Spirits
<i>Other Flavoured Beer</i>	Mezcal
<i>Radler</i>	Tequila
Low-alcohol Beer	(4 sub-categories)
Traditional Beer	Brandy
(4 sub-categories)	Cognac / Armagnac
<b>Cider</b>	(2 sub-categories)
<b>Mixed Drinks</b>	Other Brandy
FABs (Flavoured Alcoholic Beverage)	(6 sub-categories)
<i>FAB Blends</i>	Cane
<i>Other FABs</i>	Flavoured Spirits
Long Drinks	Aniseed
Pre-Mix Cocktails	(9 sub-categories)
<i>Pre-Mix Blends</i>	Bitters / Spirit Aperitifs
<i>Other Pre-Mix</i>	<i>Bitters</i>
<b>Wine</b>	(3 sub-categories)
Fortified Wine	<i>Spirit Aperitifs</i>
Other Fortified	(2 sub-categories)
(8 sub-categories)	Fruit Eaux de Vie
Port / Port Style	(2 sub-categories)
(3 sub-categories)	Liqueurs
Sherry / Sherry Style	<i>Advocaat / Egg Liqueurs</i>
Light Aperitifs	<i>Amaretti</i>
Fruit Based Aperitifs	<i>Cassis</i>
(2 sub-categories)	<i>Coffee Liqueurs</i>
Vermouth	<i>Cream Liqueurs</i>
Wine Aperitifs	<i>Licorette</i>
Other Wines	<i>Limoncello</i>
<i>Flavoured Wine</i>	<i>Liqueur Ranges</i>
<i>Ginger Wine</i>	<i>Low Strength Flavoured Genever</i>
<i>Gluehwein</i>	<i>Low Strength Flavoured Korn</i>
<i>Other Flavoured Wine</i>	<i>Low Strength Flavoured Vodka</i>
<i>Sangria</i>	<i>Low Strength Lemon Brandy</i>
<i>Fruit Wine</i>	<i>Maraschino</i>
<i>Fortified Fruit Wine</i>	<i>Other Liqueurs</i>
<i>Sparkling Fruit Wine</i>	<i>Ponche / Cremas</i>
<i>Still Fruit Wine</i>	<i>Traditional H. S. Liqueurs</i>
<i>Other Other Wine</i>	Gin and Genever
<i>Other Other Wine</i>	(7 sub-categories)
Sparkling Wine	National Spirits
Champagne	(5 sub-categories)
Other Sparkling	Rum
(7 sub-categories)	(6 sub-categories)
Still Wine	Vodka
<i>Carbonated Wine</i>	(2 sub-categories)
<i>Fruit Flavoured Still Wine</i>	Whisky
<i>Traditional Still Wine</i>	(31 sub-categories)

**Source:** Author's elaboration of IWSR database.

**Note:** The entire IWSR taxonomy includes 143 sub-categories. For better readability, the sub-categories of limited relevance for this Study are displayed in aggregated form.

### 2.1.3 Origin and nature of classification issues

Despite the complexity described above, in most cases the definition and demarcation between the different tax categories do not pose relevant interpretation problems to economic operators and administrations. This is certainly the case with spirits under CN 2208, beer under CN 2203, and standard wine under 2204. Less clear-cut is the tax treatment of certain CN 2205 products, such as aromatised wine products, as defined

under Regulation 251/2014,<sup>48</sup> which can be excised in three different ways, with sometimes subtle distinctions<sup>49</sup>:

- (i) Under Article 8 ('wine'), for an aromatised wine of 14.5%-15% vol or 14.5%-18% vol without enrichment, or an aromatised wine-based drink of 7-14.5% vol without addition of alcohol, or an aromatised wine-product cocktail with 7-10% vol.
- (ii) Under Article 17 (intermediate products), for an aromatised wine of 18-22% vol or 15%-18% vol with enrichment, or an aromatised wine with addition of alcohol, or an aromatised wine-based drink with an authorised addition of alcohol (certain aromatised fortified products, the Spanish 'Zurra' etc.) with 10-14.5% vol (or 7-14.5% in MS that have enacted the option foreseen in Article 17(2) – see Table 9 above).
- (iii) Under Article 12 (OFB), for an aromatised wine-based drink with an authorised addition of alcohol and a strength of 7-10% vol, unless the country has opted to classify them as an intermediate product in accordance with Article 17(2).

As emerged from the fieldwork interviews, the distinction between CN 2205 products categorised as 'wine' or 'OFB' is not entirely straightforward. However, since wine and OFB are equally taxed in most of EU countries (some 20 MS), and the EPC do not require / allow to distinguish between the two categories, the issue is mostly theoretical and does not cause hindrances or uncertainties to the movement and taxation of the concerned products.

Instead, as the Ramboll Evaluation and the previous study made by London Economics on the same subject show,<sup>50</sup> there are classification problems with some fermented beverages on the 'border' between CN 2206 and CN 2208 class, which have repercussion on their categorisation for excise duty purposes as 'other fermented beverage - OFB' (Article 12), 'intermediate products - IP' (Article 17), or 'ethyl alcohol - ET' (Article 20).

Both in the CN (2206) and excise classifications (Article 12), the definition of 'other fermented beverages' is less strict than for other alcoholic beverages. This reflects at the same time the heterogeneity of the products comprised (e.g. cider, perry, mead, other fruit-wines, and mixtures), the variety of national production practices ('cider' designates products with marked differences across MS), and the absence of the harmonised product definition and production rules that exist in the case of wine and spirits. Like wine, cider and fruit wines are agricultural products with a traditional origin, especially in Northern and Central Europe, and enjoy a similar fiscal regime. In particular, the Directive 92/83/EEC did not impose a minimum excise duty, and the majority of MS applies the same rates of wine, which in nearly half of MS is zero (for still OFB), and namely in: BG, CZ, DE, ES, HR, IT, CY, LU<sup>51</sup>, AT, PT, RO<sup>52</sup>, SI, and SK.

This favourable tax treatment, combined with a certain flexibility of the criteria used to define this category, made room for the development in recent years of various novel products, based on new production techniques, arguably designed to take advantage for

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<sup>48</sup> Regulation (EE) No 251/2014 of the European Parliament and of the Council of 26 February 2014 on the definition, description, presentation, labelling and the protection of geographical indications of aromatised wine products and repealing Council Regulation (EEC) No 1601/91.

<sup>49</sup> The information in this paragraph is based on CEEV - Comité Européen des Entreprises Vins' interpretation of the regulatory framework, which was shared with the Authors.

<sup>50</sup> London Economics, 'Study analysing possible changes in the minimum rates and structures of excise duties on alcoholic beverages', May 2010.

<sup>51</sup> Luxembourg has an additional duty for products containing a mix of fermented alcohol and non-alcoholic drinks.

<sup>52</sup> The zero rate applies only to cider and perry, and to some specific hydromel.

competition purposes of the low excise duty levied on OFB. Before reviewing them systematically, it is important to highlight that in many instances these novel products have been the subject of classification disputes between economic operators and customs administrations, which in a few cases escalated to the level of the Court of Justice (CJEU). These landmark cases and the related CJEU jurisprudence are essential to understand the current policy problem.

➤ **COURT OF JUSTICE LANDMARK CASES AND DEVELOPMENTS**

In the past few years, the Court of Justice (CJEU) has been called upon various times to rule on disputes regarding the customs classification of certain controversial products. The cases concerned fermented beverages mixed with distilled alcohol and/or other additives, as well as products consisting of a fermented base 'cleaned-up' so as to remove certain organoleptic characteristics. The CJEU had to establish whether fermented products produced through certain new techniques could be still classified as CN 2206 or should instead be classified as CN 2208. In all the four cases, reported in Box 2 below, the CJEU eventually established that the CN 2208 should apply.

**Box 2 – Summary of CJEU landmark cases on the classification of alcoholic beverages**

- **Case C-150/08 (Siebrand)** regarded alcoholic beverages – in specific the three beverages 'Pina Colada', 'Whiskey Cream' and 'Apfel Cocktail' – with a cider base to which distilled alcohol, water, sugar syrup, various aromas, colourings, and in one case a cream base had been added. The basic question was if these beverages may maintain the CN 2206 code – due to their cider base – or should be classified under CN 2208 as established by the Dutch customs. The Court eventually ruled that when a fermented beverage loses the taste, smell and/or appearance of a beverage produced from a particular fruit or natural product, due to the addition of distilled alcohol, water, sugar syrup, aromas, colourings and cream, it no longer falls under CN 2206, but CN 2208 applies.<sup>53</sup>
- **C-196/10 (Paderborner Brauerei)** concerned the fermented beverage 'Salitos Ice' and its 'malt beer base'. The 'malt beer base' was produced from brewed beer with an alcoholic strength by volume of approximately 14%, which was clarified and then processed with ultrafiltration techniques. The base obtained was then employed for the production of a light beer-based mixed drink. The question was if such a product had to be classified under CN 2203 or CN 2208. The Court ruling established that *'a liquid described as a "malt beer base", such as that in issue in the main proceedings, with an alcoholic strength by volume of 14% and obtained from brewed beer which has been clarified and then subjected to ultrafiltration, by which the concentration of ingredients such as bitter substances and proteins has been reduced, must be classified under heading 2208'*.<sup>54</sup>
- The joined cases **C-532/14 and C-533/14 (Toorank)** tackled the fermented beverage called 'Ferm Fruit' and a range of beverages with a 'Ferm Fruit' base to which other ingredients were added. Ferm Fruit was prepared using an alcohol resulting from the fermentation of fruit, which was then purified through ultrafiltration so that its smell, colour and taste resulted neutral. The question was if 'Ferm Fruit' (Question 1) and 'Ferm Fruit-based beverages' (Questions 2&3) had to be classified under CN 2206 or CN 2208. On question 1, the CJEU ruled that *'a beverage, such as Ferm Fruit, which is obtained through fermentation of an apple concentrate and is designed to be consumed either undiluted or as a base in other beverages, being neutral in terms of colour, smell and taste as a result of purification (including ultrafiltration) and having an alcoholic strength by volume, without the addition of distilled alcohol, of 16% falls under heading 2208 of that nomenclature'*. According to this sentence, also 'Ferm Fruit-based beverages' (Questions 2 and 3) had to fall under CN 2208.<sup>55</sup>

<sup>53</sup> Judgment of the Court (Third Chamber) of 7 May 2009, 'Siebrand BV v Staatssecretaris van Financiën', C-150/08 – Siebrand.

<sup>54</sup> Judgment of the Court (Eighth Chamber) of 14 July 2011, 'Paderborner Brauerei Haus Cramer KG v Hauptzollamt Bielefeld', C-196/10 - Paderborner Brauerei Haus Cramer.

<sup>55</sup> Judgment of the Court (First Chamber) of 12 May 2016, 'Toorank Productions BV v Staatssecretaris van Financiën', Joined Cases C-532/14 and C-533/14.

The jurisprudential consequences of the CJEU rulings are far-reaching. Although the cases referred to specific products, the Court rulings *de facto* provided more general orientations on how to interpret the classification rules with respect to new products and production techniques. In particular, the principle was established that in order to fall under CN 2206 a fermented alcoholic beverage should maintain the characteristics of smell, taste and appearance of the fruit or natural product from which it derives. It was also laid down that certain filtration processes (e.g. reverse osmosis and the like) and other technologies that neutralise the organoleptic characteristics typical of a fermented beverage, as well as the addition of distilled alcohol and other additives like sugar, water, cream, aromas etc. may elicit the application of CN 2208.

Following the CJEU rulings, a note was added to the CNEN concerning heading CN 2206 00 and stating that: '*As regards the classification of fermented alcohol-based beverages to which distilled alcohol, water and other substances (such as syrup, various aromas and colourings, and, in some cases, a cream base) have been added, see the judgment of the Court of Justice of the European Union in Case C-150/08. In accordance with the judgment, if those additions result in losing the taste, smell and/or appearance of a beverage produced from a particular fruit or natural product, that is to say a fermented beverage of heading 2206, classification under heading 2208 takes place*'.<sup>56</sup> Although not binding, this note is at the centre of various national approaches that has been developed to distinguish between 2206 and 2208 products. At the same time, as discussed further below, the underlying criteria are not of immediate implementation and may be differently interpreted. It is reported that the CN Committee and the competent Commission service are developing a regulation on this subject.<sup>57</sup>

The CJEU cases are coherent with some classification opinions issued by the WCO Harmonised System Committee (HSC) in 2011. In three cases, the HSC concluded that (i) a malt beer base cleaned-up and filtered (no. 220890/4), (ii) a fermented fruit juice cleaned-up and filtered (no. 220890/5) and (iii) a mixture of fruit wine and cleaned up and filtered alcohol (no. 220890/6) should be classified under heading 2208.<sup>58</sup> In 2012, the HSC made changes to the HS definition of 'ethyl alcohol' in order to bring its explanatory notes in line with its classification decisions. The industry reacted raising deep concerns on the implication of this decision in terms of legal uncertainties and the market functioning.<sup>59</sup>

In conclusion, it has to be noted that on one hand the CJEU rulings effectively indicated how to interpret the old rules *vis-à-vis* new products, but on the other hand the criteria selected to distinguish between CN 2206 and CN 2208 remain somehow subjective - taste, smell, appearance<sup>60</sup> - or indefinite (no specific thresholds or methods to determine the prevalent origin of the alcohol used). In this sense, the risk of disparities in the application of these criteria across national administrations persist, and the need for clearer and objective classification rules has possibly become even more pressing.

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<sup>56</sup> Explanatory notes to the Combined Nomenclature of the European Union, OJ C 76, 4.3.2015.

<sup>57</sup> At the time of writing the draft text of this new regulation was not available, so it could not be considered in the analysis of the baseline scenario.

<sup>58</sup> See decision NC 1500E1a of the Harmonised System Committee.

<sup>59</sup> An in-depth assessment was conducted by the FIVS-22 (Customs Classification) committee. Source: <https://fivs.org/wm/strategicInitiatives/fivs22.htm>

<sup>60</sup> 'Appearance' should be considered in relation to the intended use of the product. As written in the Court's judgment C-150/08: '*it is important to note that the intended use of a product may constitute an objective criterion for classification if it is inherent to the product, and that inherent character must be capable of being assessed on the basis of the product's objective characteristics and properties (...) It is common ground that the objective characteristics and properties of products such as those at issue in the main proceedings, including the form, colour and name under which they are marketed, correspond to those of a spirituous beverage.*'

➤ **PRODUCT FEATURES AND UNDERLYING CAUSES OF CLASSIFICATION ISSUES**

The classification issues analysed here are essentially determined by the introduction of new production technologies and practices and the related development of products departing from the concept of 'traditional fermented products' that – also according to CJEU's jurisprudence – was the target of Article 12. This Section briefly reviews the processes that proved problematic in this sense and the type of products concerned. To this end, we have updated the results of previous evaluations of the Directive 92/83/EEC with the evidence collected through fieldwork. Overall, the problematic practices examined are of two main kinds: (i) the use of an alcoholic base that has lost its essential fermented character, and (ii) the addition of alcohol of distilled origin and other additives to a fermented beverage.

The **fermented base** used to produce an alcoholic beverage can be processed in various ways in order to obtain, among other things, the desired strength and a neutral or partly neutral organoleptic character. These are accepted processes – although with restrictions for certain types of beverages – that are intended to optimise and stabilise the taste and smell of the product, to compensate for the effects of weather and other crop-affecting events, as well as to innovate. The OIV defines as 'Application of Membrane Techniques'<sup>61</sup> the range of practices enabling the selective holding back or passing of some compounds in the beverage, to obtain: (i) partial dehydration (concentration); (ii) partial dealcoholisation; (iii) tartaric stabilisation; (iv) adjustment of acidity and pH; (v) reduction of the concentration of certain organic acids; (vi) reduction of the volatile acidity; and (vi) the management of dissolved gas.

There are different types of membrane techniques that are used alone or in combination, in the production of a vast range of fermented beverages, known as<sup>62</sup>: (i) microfiltration, (ii) ultrafiltration, (iii) nanofiltration, (iv) membrane contactor, (v) reverse osmosis, and (vi) electromembranes processes.

The result of the application of membrane techniques may qualify as 'cleaned up' alcohol, i.e. alcohol derived from a fully fermented base, which has been subjected to processing that strip out (part of) the components that give it an essentially fermented character, and may therefore be treated in accordance with CNEN note on 2206 00 above. However, it is important to highlight that this is not automatic. The use of membrane techniques can be modulated so as to remove only certain undesirable elements without altering substantially the fermented character of the beverage. Similarly, the CNEN note does not make reference to specific production techniques – which are not even codified – but to the end-product. In other words, the application of membrane techniques does not *per se* elicit CN 2208 and also other production processes not involving the above techniques may lead to a CN 2208 classification.

For instance, in addition to the above techniques, the alcoholic strength of a beverage can also be increased and controlled through cryoconcentration techniques – consisting in partial freezing and physical removal of the ice thus formed – and other 'subtractive enrichment techniques' for the dehydration (elimination of water) of the alcoholic beverage.<sup>63</sup> Being alternative processes to fortification by addition of alcohol, some stakeholders affirm that the resulting beverage should be treated as a fortified product.

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<sup>61</sup> OIV, International Code of Oenological Practices, 2017 edition. Hereinafter: 'OIV (2017)'.

<sup>62</sup> There is no standardised description of these novel techniques that are at the moment, in most cases, only generically defined. In this sense, they poorly lend themselves to become subject to any regulatory provisions. OIV is reportedly working on a detailed description, evidently with reference to their use in the production of wine and wine-based products.

<sup>63</sup> OIV (2017).

The production of 'cleaned up' alcohol requires heavy equipment and a process that may qualify as 'industrial'. As compared to distillation, the production costs are reportedly higher, so the economic rationale of using 'clean up' alcohol for competitive advantages<sup>64</sup> seems tightly connected to the tax differential that may exist between fermented and distilled alcohol. Membrane and other concentration techniques may also be used to increase the overall strength of a fermented base without adding alcohol. This allows a higher dilution of the final product and therefore a reduction of the unit production costs, that add-up to the tax advantage of not fortifying with distilled alcohol.

Precise information on the utilisation of 'clean up' and other above-described techniques in specific products is seldom disclosed by producers. Therefore the relevant product categories could only be identified by combining qualitative evidence from interviews with assumptions derived from the market analysis. With a certain degree of approximation, the following categories may seemingly include some products containing 'cleaned up' or otherwise concentrated alcohol:

- Low and very-low strength mixed drinks with a fermented base. This heterogeneous category contains a vast range of products with a fermented base of different origin (cider, wine, malt, other fruits and grains) typically sweetened and flavoured and with an alcohol strength not exceeding 10% vol (or 5.5% vol in the case of very-low strength products). The commercial designation of these products varies and is not used consistently across countries and typology of stakeholders. Malt-based alcopops, 'wine coolers', un-hopped flavoured beer, cider and fruit-wine refreshers etc. as well as generic low-strength 'ready-to-drink' and 'pre-mixes' may all fall into this category.<sup>65</sup>
- Medium-strength pre-mixes and fermented drinks up to 15% vol. This category includes certain pre-mix cocktails with an entirely or mixed fermented base, as well as certain cream liqueurs and other flavoured liqueurs, like 'licorettes'. The fermented base is possibly mixed with (concentrated) juices, sweeteners, flavourings, creams or other ingredients. Minor quantities of distilled alcohol may be added.
- High-strength fermented beverages. This seems to be a niche category that is present only in a few national markets, and consists of product with a simple fermented base (e.g. beetroot sugar) that are highly concentrated so as to reach a strength of 15-22% and flavoured, and are presented as possible low price alternatives to spirits like vodka or whisky.

The **addition of distilled alcohol** is a well-established practice for several types of special wines and other traditional fermented beverages, and as such is regulated in sectoral legislation. However, alcohol is added also to mixed drinks with a fermented base to increase their strength. As discussed above, the economic rationale is that alcohol from distillation is generally cheaper to produce than from fermentation, and the addition of alcohol achieves the desired final strength in an easier and more flexible way. For these products, there are evidently no traditional practices so their tax treatment is entirely determined by the interpretation of the CN and excise duty classification.

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<sup>64</sup> As discussed, membrane techniques may be used for a number of production purposes, whose purposes go well beyond obtaining fiscal advantages.

<sup>65</sup> The possibility of establishing a harmonised definition of 'alcopops' at EU-level has been considered in the framework of a possible review of the mandatory labelling obligations established by Regulation (EU) No 1169/2011. However, the Report published by the Commission in March 2017 eventually concluded that 'at this stage, the Commission therefore sees no need or clear added value for a specific definition of "alcopops" for labelling purposes'. COM(2017) 58 final.

Directive 92/83/EEC clearly prohibits the addition of alcohol to beer and wine, as defined under Article 2 and Article 8 respectively. It allows instead OFB below 10% vol not to be entirely of fermented origin (below 13% in the case of sparkling OFB).<sup>66</sup> Fortified wines and fortified OFBs above the prescribed threshold can be taxed as Intermediate Products, provided they do not exceed 22% vol. However, Directive 92/83/EEC does not clarify the amount of alcohol of distilled origin that can be added to a fermented base before the tax category changes. Similarly, the CN 2206 heading admits products not entirely of fermented origin<sup>67</sup>, but the permitted amount is not specified<sup>68</sup>, and the jurisprudence in this area (i.e. the above mentioned C-150/08 case) did not establish any straightforward criteria. As a result, national customs administrations adopted different approaches to the classification of these products, combining objective criteria such as the share of distilled alcohol in volumetric terms or in terms of its contribution to the final ABV, and the subjective criteria laid down in CNEN note 2206 00. To the extent the differential in the tax rates applied to Articles 12, 17 and 20 products is high, there remains an incentive for economic operators to exploit this ambiguity.

The C-150/08 CJEU ruling, and CNEN note 2206 00, mentioned also the addition of water and other substances like syrup, aromas, creams etc. along with distilled alcohol, as a factor that might elicit the application of CN 2208. However, it is not clear whether the addition of these substances may be sufficient *per se* to classify a product as CN 2208 or only in conjunction with the addition of distilled alcohol. The evidence from fieldwork suggests that the latter interpretation prevails.

Another class of products that might incur in classification issues determined by the addition of alcohol regards beverages that contains added alcohol as a flavour-carrier (AFC). The use of aromas diluted in ethyl alcohol is widespread in the preparation of aromatised wine products. In this respect, the sectoral legislation specifies that *'the ethyl alcohol used to dilute or dissolve colorants, flavourings or any other authorised additives used in the preparation of aromatised wine products must be of agricultural origin and must be used in the dose strictly necessary and is not considered as addition of alcohol for the purpose of production of an aromatised wine product'*.<sup>69</sup> On the other hand, Article 8 of the Directive prescribed that wine must be 'entirely of fermented origin', so a restrictive interpretation of this provision may in principle lead to taxing certain aromatised wine products as intermediate products. To address this inconsistency some MS have adopted national thresholds below which the addition of alcohol as a flavour-carrier is not considered as a fortification.

In the case of OFB, the issue is evidently not relevant for products below 10% vol, but it can make a difference in the tax treatment of products above this threshold, since Article 12 prescribed, again, that the alcohol employed is entirely of fermented origin. Unlike wine, there is no EU-level legislation on aromatised OFB, so the matter is entirely left to MS authorities, and the risk of disparities of treatment is greater. In the case of beer, a similar issue emerged with spirit-flavoured products (e.g. the beer aromatised with tequila). In this case, Commission Regulation 1967/2005 solved the matter by establishing that a beer containing an ethyl alcohol flavour resulting in only 0.04% of the

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<sup>66</sup> Below 5.5% for MS that have enacted the option foreseen in Article 17(2).

<sup>67</sup> The explanatory notes and classification opinions adopted by the HS Committee relating to Heading 2206 states: *'All these beverages may be either naturally sparkling or artificially charged with carbon dioxide. They remain classified under this heading even when fortified with added alcohol or when their alcohol content has been increased by further fermentation, provided that they retain the character of products classified under this heading.'*

<sup>68</sup> When goods are *prima facie* classifiable under two or more headings, the CN rules require that classification is effectuated as follows: *'mixtures, composite goods consisting of different materials or made up of different components, and goods put up in sets for retail sale, (...), shall be classified as if they consisted of the material or component which gives them their essential character, in so far as this criterion is applicable'*.

<sup>69</sup> Regulation 251/2014.

product ABV can be still classified as CN 2203. Some MS have reportedly adopted higher threshold for the addition of alcohol as a flavour-carrier to beer.

#### ➤ **THE CHALLENGE OF ANALYTICAL METHODS**

The difficulties of determining the criteria for classifying products containing 'cleaned up' alcohol or a mix of a fermented and a distilled base, are compounded by the more fundamental difficulty for customs laboratories of determining analytically the presence and the amount of 'cleaned up' or distilled alcohol within a finished product. Nine years ago, a working group consisting of the Joint Research Centre (JRC), DG TAXUD, and eleven Member States custom laboratories was set up with a view to providing scientific support on two fundamental questions<sup>70</sup>:

- i) The extent to which a fermented product may be subjected to a 'cleaning-up' process (ultra-filtration, reverse osmosis, etc.) and be classified as a fermented beverage, intermediate product or ethyl alcohol for excise purposes.
- ii) The amount of ethyl alcohol that could be added to a fermented beverage before it becomes a product of CN code 2208.

The results of the work of the JRC working group were not encouraging. With respect to analytical methods allowing for the differentiation between 'fermented' and 'distilled' ('non-fermented') beverages, the report concluded that it would be extremely difficult or even impossible to create workable models based on analytical methods, and that difficulties would be greater precisely with those categories that are the most problematic for excise classification purposes. On the issue of 'added alcohol' the working group affirmed that it was not plausible to determine the amount through an analysis of the finished product only. In this sense, the issue at stake with certain products is not limited to possible tax circumvention but includes also the risk of fraud.

Over the years, the analytical capacities of customs has clearly evolved, and most MS have established methodologies and protocols for determining the nature of the alcohol contained in new products. In particular, various MS have set up procedures to detect with a reasonable degree of precision the presence of the by-products of fermentation in finished products and their concentration. However, the methods and the criteria vary across MS and is therefore possible that the same test carried out in different context leads to different outcomes. This may have relevant market and tax implications when such test is linked to the adoption of a Binding Tariff Information decision.

### **2.1.4 Baseline assessment**

#### **2.1.4.1 Scope of the analysis**

In this Section, we provide a more in-depth review of the products that might cause, for different reasons, classification issues. The starting point of the analysis are the four categories of problematic products identified in the Ramboll Evaluation.<sup>71</sup> The Ramboll analysis remains valid, but in order to match with the legal categories defined in the Directive and the structure of the market data available, we have used in this Study

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<sup>70</sup> JRC Scientific and Technical Reports, 'Analysis and Characterisation of Alcoholic Products (ACAP)', Fiscalis Project Group, Final Report, 2008.

<sup>71</sup> I.e. (i) RTD products (also known as 'alcopops'), (ii) Medium-strength fermented beverages between 10-15% ABV, (iii) Fermented alcohol pushed to 15-21% industrially, bottled and sold to look like its equivalent, higher rate spirit, (iv) Other products such wine to which flavours containing alcohol have been added, beer to which alcohol of distilled origin is added, sparkling wine, and cooking wine which contains additional ingredients other than alcohol.

partly different definitions and segmentation of the problematic products. In particular, the classes of beverages that may contain problematic products include:

- 1) **Mixed drinks**, including a variety of products also referred to as 'alcopops', ready-to-drink (RTD), pre-mixes etc. with an alcohol strength varying from very low (up to 5,5% vol) to low (up to 10% vol). When totally or partly based on a fermented beverage, these products may fall under Article 12, except in MS that have enacted Article 17(2) allowing to tax OFB with an ABV exceeding 5.5.% vol (8.5% vol for sparkling products) as Intermediate Product (in our sample only Italy). Medium-strength (up to 15% vol) and high-strength (up to 22% vol) mixed drinks also exist (although as a niche), but their classification issue is different, since they may fall in the border between Intermediate Products (Article 17) and Ethyl Alcohol (Article 20) category. An exception is medium-strength mixed drinks entirely of fermented origin, which may still be classified under Article 12. However, these products are very rare and therefore negligible for the purpose of our analysis.<sup>72</sup>
- 2) **Medium/high strength beverages with a fermented base**, with 10-15% vol (medium) or 15-22% vol (high). It consists of flavoured fermented beverages, possibly with a cleaned-up and/or a base of concentrated fermented alcohol, which have typically the appearance of higher strength liqueurs or spirits (e.g. 'licorettes', certain cream-liqueurs, vodka or whisky). In some cases they may also contain added alcohol. As discussed, the distinction with the above medium-strength mixed drinks with an entirely fermented base is blurred, since both classes of products can be classified (or aim at being classified) as Intermediate Products.
- 3) **Cider, perry and fruit wines**. While these products do not constitute *per se* a problematic category, the lack of a clear and harmonised definition at EU level may cause uncertainties in the proper classification of non-traditional products with characteristics similar to RTD. So, part of them may present the same issues as the above mixed drinks.
- 4) Aromatised beverages (wine, beer, cider etc.) containing **added alcohol as a flavour-carrier**.<sup>73</sup>

With the exception of the 4th group, for which a different approach is required (see Section 2.1.5.2), it can be noted that all problematic products are potentially on the border between CN 2206 and CN 2208, and as such may fall under Article 12 or Article 17 of the Directive or – if CN 2208 prevails – under Article 20. In other words, it is the 'OFB cluster' in broad sense that is at stake in this Study. The articulated composition of this cluster, and the boundaries between the various segments is shown in Table 12 below. The 'core' of the cluster is formed by cider, perry and other fruit wines and mixed drinks with a fermented base. The CN 2206 heading covers also beer mixes – intended as the mix of beer and a non-alcoholic beverage (taxed under Article 2) – 'piquette', which is wine according to Regulation 1308/2013, and aromatised wine-based drinks and

<sup>72</sup> Out of 234 brands of mixed drinks analysed in-depth, only one product seemingly belonged to the group of medium-strength OFB with an entirely fermented base.

<sup>73</sup> The Ramboll Evaluation included in this residual group also sparkling wine (because of the disparities in the definitions used for excise purposes or customs purposes) and cooking wine with additional non-alcoholic ingredients. These issues have been discarded from the present Study at the inception phase following the clarifications provided by the Commission's Inter-Service Steering Group. In fact, the disparities in the definition of sparkling wine are being discussed and addressed by the Customs Code Committee, while a new CN Explanatory Note has been recently published (OJ C 92/9 of 24.03.2017) classifying explicitly cooking wine and all cooking alcohols under CN 2103 90 90 i.e. outside of Chapter 22.



### 2.1.4.2 Analysis of market trends

#### ➤ MIXED DRINKS

In this Study, 'mixed drinks' (MD) designates a commercial (non-legal) category of products consisting of a blend of a CN 2206<sup>75</sup> and/or CN 2208 products with another beverage (alcoholic or non-alcoholic) and/or water, sugar, aromas or other substances. The result is a 'ready-to-drink' (RTD) beverage with a strength that varies from less than 5.5% vol ('light' mixed drinks, as the majority of 'alcopops'), to 10% (most of RTD 'long drinks'), and up to 15% (typically pre-mix cocktails). Certain mixed drinks can be found also above this threshold, but these drinks are a niche market. In principle, the category of mixed drinks does not include OFB like cider, perry, fruit-wines etc., but as discussed further below in some cases the distinction is blurred, especially for products flavoured and/or with added alcohol.

The overall data on the mixed drink markets are drawn from IWSR database, which further distinguishes between flavoured alcoholic beverages (FABs), long drinks, and pre-mix cocktails. However, these sub-categories have been redefined over time so there are breaks in time series. Furthermore, the IWSR classification does not always coincide with the CN and excise duty classification. For this reason, we have re-classified all mixed drinks covered by IWSR into sub-groups based on alcohol strength and type of alcohol base, which are the two main variables to determine the tax treatment. The analysis has been conducted on the six sample MS selected, then extrapolated at EU level, using IWSR top-line data. The methodology required web research on a representative sample of 234 products, representing almost 90% of the mixed drinks market in the sample MS. Findings and assumptions were cross-checked through interviews with stakeholders (where available) and the analysis of selling prices.

The outcome of the exercise (Table 13 and Table 14 below) provides a general estimate of the market trends for mixed drinks in the EU, but have to be taken with some caution for two main reasons. First, the alcohol base used in a mixed drink is typically not disclosed. The fact that a certain product contains e.g. rum or vodka does not prevent that also fermented alcohol is included (in unknown proportion). This may eventually determine if the product comes under CN 2206 or CN 2208.<sup>76</sup> Secondly, the same product may be commercialised in different MS with different formulas or alcohol strengths. These characteristics may also vary over time, since mixed drinks typically have a short life-cycle and are modified every few seasons. Changes may be driven by consumers' preferences but also by 'tax optimisation' opportunities.

**Table 13 – Market trends for mixed drinks, in million litres (2003-2016 and forecast growth rate for 2017)**

MS	[2003]	2010	2011	2012	2013	2014	2015	2016	F2017	CAGR 2003-2016	CAGR 2010-2016
DE	81.41	14.00	18.53	21.56	22.57	23.12	23.90	25.79	3.5%	-8%	5%
FI	25.90	48.78	50.63	48.17	39.50	38.00	34.70	31.94	-11.1%	2%	-3%
FR	25.26	11.15	11.09	10.32	9.95	10.57	10.72	9.88	-1.6%	-7%	-1%
IT	50.40	29.77	29.79	26.86	23.85	21.89	20.19	19.40	-3.5%	-7%	-3%
NL	20.43	9.23	9.48	9.82	9.68	8.94	9.29	9.90	2.3%	-5%	1%
RO	0.31	0.72	0.86	0.87	0.64	0.60	0.29	0.32	3.2%	0%	-6%
EU	517.41	300.39	303.11	283.11	256.07	244.39	232.59	221.91	-4.1%	-6%	-2%

**Source:** Author's elaboration of IWSR data.

**Note:** The CAGR (Compound Annual Growth Rate) is the mean annual growth rate over the time period considered.

<sup>75</sup> In a few special cases, also CN 2205.

<sup>76</sup> In the absence of a BTI, national authorities may have different positions in this regard.

**Table 14 – Estimated distribution of mixed drinks by ABV strength (in million litres), and alcoholic base (2016)**

ABV strength	DE	FI	FR	IT	NL	RO	6 MS aver.	EU	Ferm. % (EU)	Ferm. amount (EU)
<b>Very low</b> ≤ 5.5% vol	8.91	31.66	3.87	3.40	4.27	0.29	54%	119.40	61.7%	73.64
<b>Low</b> ≤ 10% vol	14.30	0.23	0.00	15.82	5.40	0.03	34%	74.48	6.4%	4.76
<b>Medium</b> ≤ 15% vol	2.05	0.04	2.44	0.13	0.23	0.00	6%	13.62	15.4%	2.55
<b>High</b> >15% vol	0.52	0.00	3.57	0.05	0.00	0.00	6%	14.40	<0.1%	<0.01

**Source:** Author's elaboration of IWSR data.

**Notes:** the distribution of products across ABV strength categories is based on a sample of 234 products, which represent 90% of the market size according to IWSR. Then, the distribution observed has been extended to the entire mixed drinks category 'pro quota'. The EU-level distribution is estimated using the average proportion among the ABV strength categories of the six sample MS (simple average).

The 'Ferm.' data refer to the amount and share of mixed drink with a fermented base or a mixed fermented / distilled base likely to be classified CN 2206. The estimate is based on an analysis of the above sample of 234 products in the six sample MS and, given the absence of official data, is subject to a high degree of approximation. The 'EU %' is calculated as the simple average of the distributions estimated for the six sample MS, assuming it is representative of the entire EU market. The amount in million litres derives from the estimated percentages per ABV strength category.

The market trends displayed in the above Tables show a general decline in the consumption of mixed drinks, both in the long (2003-16) and medium (2010-16) terms. The estimated overall sales in the EU have fallen from more than 500 million ('mn') litres in 2003 to some 300 mn in 2010 and further down to ca. 222 mn last year. The trend was uneven across countries: (i) in IT, FR and NL the decline was steady, although in FR and NL it was more marked in the earlier period, and since 2010 the market is fluctuating; (ii) in DE there was a steep drop after the introduction of the 'alcopop' tax in 2003, now the market is catching up thanks to the introduction of fermented-based mixed drinks; (iii) RO and FI followed opposite trends, with a steady growth until 2011-12 followed by a quite rapid decline.<sup>77</sup> The outlook for the near future is negative, and the EU market is overall set to further decline at a -2% rate per annum. The stakeholders' views collected via OPC are only slightly more optimistic: according to the industry, RTDs are mostly stable, while individual respondents perceived an increase in the spirit-based RTDs.

The geographical concentration of markets is moderately lower than before. In 2003, the three main markets (UK, DE and IT) accounted alone to some 70% of the EU market, while in 2016 the aggregated volume of sales in the three biggest markets (UK, DE, and FI) amounted to some 53%. Finland is the singularity of the distribution. Low-strength long drinks RTD are extremely popular in the country. The consumption per capita exceeds 6 litres / year.<sup>78</sup> For comparison, in the UK – which is still the biggest market for mixed drinks – the per capita consumption amounts to less than one litre / year.

<sup>77</sup> The estimates provided here somehow differ from the market data contained in the Ramboll Evaluation, which were based on *Euromonitor* instead of IWSR database. As discussed, 'mixed drinks' is not a legally defined category, so market estimates may vary according to the definition used and the classification methodology. The main discrepancy regards the German market that, according to *Euromonitor*, amounted to an overall 110 mn litres in 2014 (instead of 23). However, the definition used in the Ramboll report includes also some 75 mn of wine-based RTD, that IWSR likely classified among aromatised wine products (under the 'wine' heading). On the other hand, spirit-based RTDs are estimated by Ramboll some 16 mn, which is perfectly in line with our estimate provided in Table 14.

<sup>78</sup> To which part of the Estonian 1.5 mn litres sales should be added, due to the intense cross-border shopping between the two countries.

Based on our analysis of a large sample of products, very low strength mixed drinks with an ABV below 5.5% account for more than half of the category (54%). Products between 5.5% and 10% vol represent approximately one-third of the total (34%) and the remaining 12% is evenly divided between medium-strength (10% - 15% vol) or high-strength (> 15%) beverages, typically certain pre-mix cocktails. A significant variance exists across countries, so these estimates have to be taken with some caution. The distribution often follows the opportunities, for instance: (i) in Finland products below 4.7% vol may be sold in supermarkets, so most of 'long-drinks' fall under this threshold; (ii) similarly in NL, products above 15% vol may be sold only in authorised liquor shops, so products right below this ABV threshold have proliferated; (iii) in France there is both the 'pre-mix tax' affecting products below 12% vol and an extra charge on products exceeding 18% vol, so there are various mixed cocktails falling in this ABV window. Notably, the same brands of mixed drinks sometimes have different ABV strength in different countries. Moreover, as discussed below, the sales of mixed drinks is related with national consumption habits of other products, so the 'low-strength' category is nearly nil in France, where AWP aperitifs are very popular. In Germany, the 'very low' category has to compete with a wide offer of fruit-wine drinks.

The fermented or spirit-based nature of products was more difficult to assess. The labelling information may partly help, especially for products that are entirely of one kind, but the possible blend of fermented and distilled alcohol in the same product had to be inferred triangulating interview information, miscellaneous web sources, and an analysis of the price and possible tax-bearing capacity of products. Ultimately, the distinction that is of relevance for this Study is between products that are treated as CN 2206 or as CN 2208. But since the uncertainty of this distinction is precisely the reason why the matter is being examined, it is evident that our attribution entails a certain margin of error. This is even more probable, since a qualitative review of the EBTI database showed that there are products with apparently similar descriptions that are classified differently across MS (see Box 5 below).

The results of the analysis of the alcohol base used in mixed drinks relate only to the EU level, since the number and type of observations available at country level were too heterogeneous to formulate robust statements at such level. Overall, we have estimated that about 36.5% of the mixed drinks market (in volume of end-products) is made of products with a complete or partial fermented base sufficient to be classified as CN 2206 and taxed under Article 12 (OFB), or Article 17 (IP) for products exceeding 10% vol. The rest is presumably entirely or prevalently spirit-based beverages, classified as CN 2208, and taxed under Article 20 (ethyl alcohol). The share of CN 2206 mixed drinks seem higher below 5.5% vol – where Article 12 regime is 'guaranteed'; smaller in the 5.5%-10% vol range, which some MS may consider as Intermediate Products in line with Article 17(2)<sup>79</sup> and where special taxes on mixed drinks hit the most; and moderate in the 10-15% vol range, where there could be greater tax incentives to compete with spirit-based products. The market volume of fermented mixed drinks above 15% vol is negligible.

#### ➤ **MEDIUM/HIGH STRENGTH BEVERAGES**

The second category of products that potentially pose classification challenges includes medium / high strength beverages (i.e. 10% to 15% vol, or 15% to 22% vol) with an entirely fermented base or including added alcohol (in which case the distinction with mixed drinks become blurred). The category described here does not include traditional Intermediate Products like fortified wine or aromatised wine products which are clearly regulated, and it should only comprise of 'borderline' products, i.e. products that might

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<sup>79</sup> It has to be considered also that a mixed beverage of 9-10% vol is difficult to obtain using only fermented alcohol, and probably requires some concentration process.

take advantage of classification ambiguities to obtain a more favourable tax-treatment. The category includes so-called 'licorettes', as well as a various range of similar products for which there is no specific, commercial denomination.

This category of products is at the basis of the CJEU landmark classification disputes C-150/08, C-532/14 and C-533/14, which regarded respectively a range of liqueurs with a mixed fermented and distilled base, and an alcoholic strength of 14% vol, and a cleaned-up fermented beverage – denominated 'Ferm Fruit' – to be consumed either undiluted or as a base in other beverages of 14% vol. The CJEU rulings evidently put a major stumbling block on this type of beverages, but the evidence from interviews suggests that 'licorettes' and other flavoured liqueurs with a fermented base are still on the market, although their prevalence across countries and product categories is difficult to estimate precisely. In a few cases, the entirely fermented nature of the beverage was clearly indicated on the label or was retrieved through commercial platforms and interviews with distributors. In other cases, we have tried to infer it comparing the price and characteristics with other products in the same categories, discounting the applicable excise duty. The underlying assumption, which was confirmed in all interviews with stakeholders, is that 'borderline' products are generally found in the 'value' segment of the market, where tax optimisation is more important than for premium brands.

During fieldwork, we have also collected evidence of entirely fermented beverages with a strength up to 21% that are placed on the market as end-products<sup>80</sup>, or traded in bulk for subsequent dilution and preparation of various beverages. According to some sectoral experts, it can be assumed that this type of products have undergone reverse osmosis or other alcohol concentration processes in order to reach such a high ABV. The issues are of two kinds: (i) in the case of end-products, there seems to be diverging views across MS on how to treat them tax-wise; (ii) in the case of bulk products, the classification of the beverages produced from these bases may be uncertain. Unfortunately, trade data on this 'niche' typology are unavailable so only a qualitative assessment was possible.

Table 15 below provides an overview of the market trends for flavoured spirits, which is the broader category that probably includes the 'borderline' products described above. The following Table 16 reports the result of our in-depth analysis of a sample of 116 products aimed at identifying those possibly having a possible fermented base and thus classifiable as Intermediate Products and at estimating their volume in the six sample MS and at EU level.

**Table 15 – Market trends for flavoured spirits, in million litres (2003-2016 and forecast growth rate for 2017)**

MS	[2003]	2010	2011	2012	2013	2014	2015	2016	F2017	CAGR 2003-2016	CAGR 2010-2016
DE	150.13	148.95	149.12	143.15	143.25	140.99	138.69	139.52	0.2%	-0.6%	-1.1%
FI	4.09	4.71	4.71	4.38	4.23	3.86	3.81	3.83	-0.2%	-0.5%	-3.4%
FR	176.29	147.42	145.33	136.07	134.50	130.47	127.73	126.04	-1.1%	-2.5%	-2.6%
IT	76.72	77.53	77.94	74.53	72.49	73.97	72.81	72.57	-1.1%	-0.4%	-1.1%
NL	24.36	24.84	24.30	24.07	23.70	21.94	20.63	19.66	-3.7%	-1.6%	-3.8%
RO	76.01	73.29	71.75	70.09	69.49	66.75	64.69	64.28	-5.2%	-1.3%	-2.2%
EU	797.95	777.27	773.85	748.89	743.35	723.14	708.41	704.37	-0.7%	-1.0%	-1.6%

**Source:** Author's elaboration of IWSR data.

**Note:** The CAGR (Compound Annual Growth Rate) is the mean annual growth rate over the time period considered.

<sup>80</sup> In the Ramboll Evaluation, these products were defined as 'fermented alcohol pushed to 15-21% industrially, bottled and sold to look like its equivalent, higher rate spirit'.

**Table 16 – Estimated consumption of medium/high strength beverages with a fermented base (2016)**

	DE	FI	FR	IT	NL	RO	EU
<b>MHS Ferm.</b> (million litres)	6.12	1.00	14.10	4.08	4.43	4.56	<b>72.94</b>
<i>as a % of Flavoured Spirits</i>	4.4%	26.1%	11.2%	5.6%	22.5%	7.1%	<b>10.4%</b>

**Source:** Author's elaboration of IWSR data.

**Legend:** MHS Ferm.: medium/high strength beverages with a fermented base (other than wine and beer).

**Notes:** the IWSR sub-categories that entered this analysis included: bitter/spirits aperitifs, coffee liqueur, cream liqueur, licorettes, advokaat/egg liqueur, ponche / cremas, rabarbaro, liqueur ranges, other spirit aperitifs, and other liqueur. The residual 'other' categories account for the majority of the supposed MHS Ferm, followed by liqueur ranges and licorettes. In the other categories the amounts of MHS Ferm are marginal.

Based on a sample of 116 products representing 73% of the market for the identified categories. In the first step a distinction between possible MHS Ferm and products falling under CN 2208 was made, based on a review of label information, price and other miscellaneous information sources. The estimated share of MHS Ferm in our sample was then propagated to the total volume of the sub-category, then summed to the other sub-categories. Then the share of MHS Ferm on the macro-category of flavoured spirits is estimated for each country. The simple average of these measures was applied to the total EU market of flavoured spirits (Table 15) to estimate the total EU market of MHS Ferm.

Market data indicate that the overall Flavoured Spirit category of product has been slowly but steadily declining for many years. From nearly 800 mn litres in 2003 sales have seemingly decreased to ca. 700 mn litres in 2016. This process was seemingly faster in recent years in NL and FI than in DE or IT, and the short-term perspectives are similar. Looking into sub-products, all types of beverages have been declining except the bitter / spirit aperitifs whose increased consumption have partly compensated losses in other categories like liqueurs and aniseed beverages. As discussed, estimating the share of products possibly classified as CN 2206 required some strong assumptions, so results have to be taken with great caution. Country-level data have limited significance due to the high margins of error, but overall the exercise led to formulating an EU-level assumption that seems plausible for further analysis. According to it, some 73 mn litres of medium/high strength beverages with a fermented base (other than wine and beer) are possibly traded in the EU every year.

The existence of such products is confirmed through other ways by the analysis of the BTI decisions taken in different MS (see Box 5). More details on the individual products are difficult to gather since, as said, the category seems to mainly consist of a long tail of minor brands (often 'private label' products) with limited sales volumes and a quite short life-cycle.

#### ➤ **CIDER, PERRY AND FRUIT WINES**

Cider is defined in several MS legislation but not at the EU level. The CN classification distinguishes at the 8-digit level between cider & perry and other fermented beverages, while there is no reference at all to cider in Directive 92/83/EEC. The definition of cider as well as of perry and other fruit wines, and the admitted practices, vary greatly across countries, so that a product that is considered cider in one country may be treated as a generic OFB in another one. Since the customs tariff and the excise duty category generally does not change (with the exceptions of FR and RO), the issue has however limited implications in this regard. Instead, definition matters for commercial denomination and labelling aspects: i.e. French *cidre*, Spanish *sidra*, German *apfelwein*, Romanian *cidru* etc. are regulated denominations that can be used only by products meeting certain requirements. Other OFB products may still be placed on these market using the generic term 'cider' (in English).

The IWSR database seemingly adopts a pragmatic approach to cider definition, and whatever is marketed as cider is recorded as such, regardless of specific national denomination rules. This entails that the IWSR market data reported in Table 17 may actually include an heterogeneous range of beverages, which may differ, *inter alia*, by: (i) raw materials (apple, pears, other fruits and blends of them, etc.); (ii) production processes (minimum amount of fresh juice, addition of sugar and syrup, carbonation,

'ice cider' etc.); (iii) alcohol strength (there is a 'cap' at 8.5% vol in SE, FI, UK, but not in BE, IE etc.); and (iv) possible flavourings. The addition of alcohol for fortification purposes is generally not admitted, but it can be used in some contexts as a flavour-carrier.

It has to be noted that the IWSR estimates do not always match with market estimates collected at national level. For instance, in the case of Germany, the IWSR estimates are lower than the estimates reported by the national trade association on *apfelwein* and related products.<sup>81</sup> For the overall coherence of the exercise it seems nonetheless preferable to use one single source of data rather than a patchwork of different national sources.<sup>82</sup>

**Table 17 – Market trends for cider, in million litres (2003-2016 and forecast growth rate 2017)**

MS	[2003]	2010	2011	2012	2013	2014	2015	2016	F2017	CAGR 2003 2016	CAGR 2010 2016
DE	42.40	43.50	44.50	45.00	45.50	45.50	45.00	46.00	1.6%	0.6%	0.9%
FI	54.49	50.00	47.25	43.50	36.20	34.12	29.55	27.00	-6.3%	-5.3%	-9.8%
FR	113.39	92.79	89.09	87.99	87.99	87.49	85.47	81.49	-1.7%	-2.5%	-2.1%
IT	..	0.10	0.12	0.22	0.35	0.47	0.60	0.72	13.8%	n/a	39.1%
NL	..	1.50	3.00	3.50	4.00	4.40	4.70	5.20	5.8%	n/a	23.0%
RO	..	..	..	..	..	..	..	19.93	25.4%	n/a	n/a
EU	974.93	1103.72	1112.15	1139.66	1167.69	1227.33	1217.06	1236.89	1.18%	1.8%	1.9%

**Source:** Author's elaboration of IWSR data.

**Note:** The CAGR (Compound Annual Growth Rate) is the mean annual growth rate over the time period considered.

The geographical distribution of cider consumption in the EU is highly skewed. A few countries with a solid tradition of cider-making – including UK, IE, FR, ES, DE (including fruit wines) FI, and the Baltic states – constitute 93% of the total European market. The UK alone consumes two thirds of the total. In recent years, cider has gained some popularity in MS that had no significant tradition, like RO, PL, CZ, HU, PT and the NL. In absolute terms, the level of consumption is still modest, but it is growing at a very fast rate. This growth compensates the opposite trend registered in some cider traditional countries: in France consumption dropped from 113 mn in 2003 to 82 mn last year; in Finland the decline was even faster, close to -10% on an annual basis. The result of these opposite dynamics is a slow, steady growth at EU level of 1-2% per year. This is confirmed by most OPC of respondents, for whom cider consumption is mostly stable, except for some industry players who see a moderate increase.

Interestingly, the recent success of cider in countries with no established tradition is mostly due to a few mainstream brands introduced by big international manufacturers rather than to local market development. These products are generally more in line with the more 'permissive' definitions of cider - as regards the minimum amount of fresh juice and other substances added - and they would not qualify as real cider according, e.g., to the Romanian or French definitions. The matter is discussed further in the following Sections, but it is useful to anticipate that for the purpose of the market analysis it is very difficult to draw a line between what is a 'traditional' or 'real' cider and what is a cider-like beverage, 'white cider' or an OFB containing apple flavour.

<sup>81</sup> Source: VdFw, 'Arbeitsbericht', 2017. The overall fruit wine and fruit wine cocktails cluster is estimated at 75 mn litres per year, of which cider and perry would amount to 37 mn.

<sup>82</sup> According to AICV estimates (based on *Canadean* market intelligence), also the Finnish market is greater than in IWSR estimates: i.e. 40 mn. Finnish THL provides an in-between estimate of 35 mn of litres. The same for NL that according to Canadean consumes 7.7 mn litres per year. In the case of RO, instead, Canadean provides a much smaller figure (7.8 mn), but the IWSR data seem more in-line with industry estimates collected during the fieldwork (16 mn). The estimates for France are coherent.

For analytical purposes, we have anyway attempted to differentiate between 'traditional' cider – as variously defined across MS – and other 'mass-market' products based on cider (or other OFB). Since according to certain national definitions the latter would not qualify as cider in strict sense, in this Study we designate them as 'borderline' cider. In this respect, it must be highlighted that, unlike mixed drinks and the 'borderline' OFB and IP described above, 'borderline' ciders are arguably not designed to obtain a more favourable tax treatment, since both traditional and non-traditional products fall in any case in the OFB (Article 12) category. The economic rationale of 'borderline' cider seems lower production costs, through the possible use of concentrated juice, sugar, water etc.

Of the six MS in our sample, IT and NL are minor cider markets, so the distinction has limited relevance. The situation in the other four MS seems skewed: (i) in France, traditional *cidre* seems the overwhelming majority;<sup>83</sup> (ii) in Germany, the legal definition is a bit more permissive so it is possible that a certain share of the market (estimated at about one-third) correspond to the 'borderline' category; (iii) in Romania and Finland the overwhelming majority of ciders seem of the 'borderline' type. Extrapolating these estimates to the EU level requires some caution, not only for the margins of error in the attribution of products to the two sub-groups, but also since the sample MS represent only 15% of the total cider consumed in the EU, due to the big outlier, the UK, which account for two-thirds of the total EU cider. Based on our market analysis, the 'borderline' cider in the sample MS amounts to an estimated 36%, i.e. some 65 mn litres. Assuming a similar incidence of 'borderline' cider across the EU, the amount of 'borderline' cider would amount to approximately 152 mn litres - without the UK - or 435 mn litres including the UK.

#### ➤ PRODUCTS CONTAINING ALCOHOL AS FLAVOUR-CARRIER

The last category of products that potentially poses classification challenges are fermented beverages of all kinds (beer, wine, cider, fruit-wines) that are flavoured with aromas diluted in ethyl alcohol. As discussed, the Directive definitions exclude the possibility of adding alcohol to these beverage (except for OFB below a certain ABV), therefore a strict interpretation of it would in principle lead to categorise several aromatised beverages as Intermediate Products. In practice, this seldom happens since EU and national sectoral legislation and administrative rules have established 'safe havens' for the addition of minimal amounts of alcohol for exclusive flavouring (and not fortification) purposes. In some cases, explicit limits have been set, in others it is left to case-by-case decisions.

From a market analysis perspective it turned out unfeasible to determine with a sufficient degree of accuracy which products contain alcohol as a flavour carrier (AFC) and which ones do not, since this is not used as a differentiating criterion in any of the existing classifications. Similarly, customs administrations and trade associations were in general not able to provide estimates because under a certain threshold there is no requirement to declare this addition.

Against this background, only hypothetical scenarios about the size of the market of these products can be drawn. To this end, Table 18 below shows the market trends for certain product categories (commercially defined) that may contain an unknown share of products flavoured with aromas diluted in ethyl alcohol. The analysis is limited to AWP and flavoured beer. OFB is not included since under 10% vol the addition of alcohol is in any case permitted and above this threshold flavoured cider or fruit wines are rare. The three hypothetical scenarios drawn in Table 18 assume that the share of products possibly using alcohol as a flavour-carrier is respectively (i) 25%, (ii) 50%, or (iii) 75%.

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<sup>83</sup> Our assessment based on IWSR data was confirmed by the French trade associations, which estimate traditional cider above 95%.

**Table 18 – Market size of product categories possibly containing alcohol as a flavour carrier**

Categories	6 MS	EU	Ratio 6 MS / EU	CAGR***	Share (%) of products containing AFC - hypothetical scenarios		
					I - 25%	II - 50%	III - 75%
	<i>mn litres</i>	<i>mn litres</i>		<b>2014-17</b>	<i>mn litres</i>	<i>mn litres</i>	<i>mn litres</i>
<b>Flavoured Beer*</b>	224.9	554.1	41%	12.6%	138.5	277.1	415.6
<b>Vermouth**</b>	43.4	101.7	43%	-3.2%	25.4	50.8	76.3
<b>Other flavoured still wine</b>	82.7	189.2	44%	8.2%	47.3	94.6	141.9
<b>Other flavoured sparkling wine</b>	5.6	10.5	53%	9.7%	2.6	5.3	7.9

**Source:** Author's elaboration of IWSR data

**Note:** (\*) radler beer is not included; (\*\*) vermouth is typically fortified, so only a small share of this category seems relevant for the issue at stake; (\*\*\*) the CAGR includes IWSR's forecast for 2017.

The market data above show that the most important category for both size and growth rate is flavoured beer. Approximately half billion litres of flavoured beer (not considering radler beer) was consumed in the EU in 2016, of which approximately half in the six sample MS. The compounded growth rate in this segment amounts to a significant 12.6% per year. Based on stakeholders' views, spirit-flavoured beer, like beer aromatised with rum or tequila, represents a high share of this category. As discussed, these products were addressed by Regulation 1967/2005 and therefore do not pose classification issues.

With the exception of vermouth, the market of aromatised wine products also seems to be growing steeply. In absolute terms, still products account for the most of it (ca. 190 mn litres), while sparkling are still a niche (ca. 10 mn litres). Typology of products and patterns of consumption are highly country-related, but the six MS considered seemingly provide a fairly robust representation of the overall EU consumption.

### 2.1.4.3 Excise Duty Treatment and Regulatory Measures

#### ➤ EXCISE DUTY LEVELS AND TRENDS

The excise duty rates applied to the different categories of products are not *per se* in the scope of the impact assessment, however their respective levels and trends are important to consider, in order to better understand the market and the fiscal policy context of classification issues.

The excise duty level applied in the MS have remained substantially stable over the past few years (Table 19). Of the six sample MS, Germany has never adjusted its rates, while in Finland, Italy and the Netherlands only a few minor changes amounting to less than 5% on an annual basis have been registered. More marked has been the revision of rates in France, where the standard excise duty for beer jumped from EUR 2.7 to EUR 7.2 in 2013, and the excise duty on high strength ethyl alcohol increased by 30% in 2012. In Romania, significant fluctuations were registered in the 2014-2016 period: (i) the excise duty on still OFB initially dropped (2014) and a distinction with 'traditional' cider, perry and hydromel was introduced, then, in 2016, the rate for other generic OFB was raised to almost the pre-2014 level (the same level of IP); (ii) the rate on sparkling OFB remained constant until 2016, when the above distinction between sub-classes of OFB was introduced, and the tax rate was significantly reduced; (iii) as regards spirits, a significant increase of ca. 40% was adopted in 2014, but then in 2016 the rate went back to the 2013 level.

The dynamics registered in the six MS examined are not dissimilar to the general EU trends and the sample offers a balanced representation of the overall EU average. With specific regard to the OFB category that is examined in this Study, it is interesting to note that nearly all MS apply the same tax treatment to wine and OFB. In the case of

still products, only HU and MT have a different standard rates, while for DK, IE, PL, and RO some differences exist only with sub-categories of products (e.g. cider and perry v. other OFB). In the case of sparkling products, only FR and MT set different excise duty levels. In this sense there is still a general recognition that OFB and wine deserve the same tax treatment. Many countries also apply the same rate to still and sparkling OFB (and wine), the only exceptions being BE, CZ, DK, DE, IE, HU, NL, AT, SK and UK who tax sparkling OFB more heavily, and RO who tax them less heavily (except cider, perry and hydromel).

Overall, the excise duty levied on OFB is among the lowest, especially for still products. Some 12 MS apply a zero rate on still OFB (8 MS in the case of sparkling OFB) and the overall average excise duty is EUR 73/hl (still) and EUR 119/hl (sparkling).<sup>84</sup> The variance of OFB tax rates is high (rates vary from nil to more than EUR 400/hl) but not higher than for other categories of product.

**Table 19 – Excise duty levels and overtime evolution 2010-2016 (six sample MS and the EU)**

	DE	FI	FR	IT	NL	RO	EU average
<b>Beer</b> (€/hl/% vol or €/hl/° Plato)	0.79*	32.05	7.41	3.04*	3.45*	0.75*	Plato: 1.86* Vol: 11.6
CAGR 2010-16	0.0%	3.6%	18.3%	4.4%	2.9%	-0.02%	4.0%
<b>Wine still</b> (€/hl)	0.00	339.00	3.77	0	88.36	0.00	80.65
CAGR 2010-16	0.0%	3.1%	1.0%	0.0%	3.8%	0.0%	7.0%
<b>Wine sparkling</b> (€/hl)	136.00	339.00	9.33	0.00	254.41	20.73	131.73
CAGR 2010-16	0.0%	3.1%	1.0%	0.0%	0.9%	-7.9%	5.9%
<b>OFB still</b> (€/hl)	0.00	339.00	1.33 – 3.77 **	0.00	88.36	89.87 – 0.00**	72.99
CAGR 2010-16	0.0%	3.1%	1.0%	0.0%	3.8%	-2.0% – -100.0%**	4.0%
<b>OFB sparkling</b> (€/hl)	136.00	339.00	1.33 – 3.77 **	0.00	254.41	10.73 – 0.00**	119.02
CAGR 2010-16	0.0%	3.1%	1.0%	0.0%	0.9%	-21.0% – -100.0%**	4.6%
<b>Intermediate products</b> (€/hl)	153.00	670.00	188.41 – 47.11***	88.67	149.29	89.87	188.63
CAGR 2010-16	0.0%	2.8%	-2.8%	4.4%	3.3%	-9.6%	3.1%
<b>Ethyl alcohol</b> (€/hl of pure alcohol)	1,303.00	4,555.00	1,737.56 – 2,295.46****	1,035.52	1,686.00	748.88	1,823.19
CAGR 2010-16	0.0%	2.5%	2.3%– 5.4%****	4.4%	1.9%	-0.02%	2.4%

**Source:** Author's elaboration of EDT series.

**Notes:** EU-level data are calculated as a simple (non-weighted) average of the 28 MS. The table reports only standard rates applicable to standard products in each category. Reduced rates and other national specific provision are not taken into consideration.

CAGR: compound annual growth rate.

For beer, in the case of multiple excise duty ranges by Plato degree, the median value is reported.

(\*) excise duty expressed in EUR per hl / degree Plato

(\*\*) France and Romania applies differentiated excise duty to cider, perry and hydromel (and 'pétillants de raisins' in FR).

(\*\*\*) France apply a different rate for 'vin doux naturel'. It also applies an additional levy for IP exceeding 18% vol.

(\*\*\*\*) France applies an additional levy for Ethyl alcohol exceeding 18% vol.

## ➤ NATIONAL REGULATION AND APPROACHES

A number of MS have adopted *ad hoc* measures for the tax treatment of OFB – and where relevant IP – arguably motivated by the need to differentiate between

<sup>84</sup> The comparison with beer is not immediate since it depends on the strength. For example, the average rate in the EU of a beer with 5% vol is ca. 58 €/hl (for MS using the ABV scale).

subcategories of products. As discussed above, the OFB category has expanded overtime to include a variety of new products: first and foremost mixed drinks with a fermented base, but also sweetened and flavoured cider, aromatised wine products (below 7% vol), and - at a higher-strength level - liqueurs with an entirely fermented base. The IP category has seen the proliferation in some MS of 'licorettes' and other medium/high strength liqueurs with a fermented base. Some of these *ad hoc* approaches are evident from the analysis of the national tax regulations, others emerged from the direct interviews with administrations and stakeholders. Three aspects in particular are analysed in the following paragraphs: (i) the differential tax treatment of traditional and mass-market OFB; (ii) additional non-harmonised taxes for special products (alcopops, pre-mixes etc.); (iii) national approaches to the criteria to distinguish between CN 2206 and CN 2208.

- **Differential treatment among different types of OFBs.** Five MS have differential treatments for OFB of different natures, namely: IE, PL, FR, RO, HU, and UK. With the exception of HU that has introduced a zero rate for 'unflavoured still mixture of wine and carbonated water below 8.5% vol', in all other cases the distinction regards cider, perry and sometimes hydromel versus any other unspecified OFB. In these cases, the definition of cider and other products is laid down in national legislation: agricultural legislation in the case of FR<sup>85</sup>, PL<sup>86</sup> and RO<sup>87</sup>, tax or general sectoral legislation in the UK<sup>88</sup> and IE<sup>89</sup>. According to AICV, at least seven more MS have a national legal definition of cider but this is apparently not used for tax differentiation purposes.<sup>90</sup> The differences between definitions clearly reflect domestic markets and production practices, and more generally, reveal the concern that certain OFB of uncertain composition may have access to a tax structure that was designed for 'traditional' agricultural products. This may apply to countries where a cider tradition is well established (such as FR, IE and the UK) as well as countries of more recent introduction of these products (RO and PL).

As seen above, some national definitions are restrictive while others more permissive. For instance, in Romania it is required that *cidru* is made with 100% fresh apple juice and no water can be added; France imposes that at least 50% comes from fresh juice, and water is admitted only to reconstitute the apple concentrate; Sweden requires a minimum 15% juice in the final product; no minimum juice content is required in e.g. Ireland, Belgium and others. Sugar and flavourings are admitted in most countries, but some countries restrict their use to certain phase of the process or specific categories of products. What is real cider and what is instead a generic OFB is debated also at the level of industry and consumers, with different positions and views on permissive versus restrictive definitions. Trade associations are reportedly considering a rather 'permissive' definition of cider<sup>91</sup> – i.e. no minimum amount of fresh juice, sugar and certain additive permitted, but no fortification allowed – which *de facto* comprises all 'mass-market' products currently on the market. Conversely, the consumers' organisation *Campaign for Real Ale (CAMRA)* drafted a list of products that they do not consider 'real' cider primarily because they have been carbonated, pasteurised, micro-filtered, or are based on

<sup>85</sup> Decret No 87-600, 1987 and Arrêté of 13 November 1987.

<sup>86</sup> Polish Ministry of Agriculture, 'Act on the Production and Bottling of Wine Products, Trade in these Products, and Organisation of the Wine Market', 2010.

<sup>87</sup> Romanian Ministry of Agriculture, Order No 474/2014 of 28.03.2014, abrogated by Order No 1541/2014 of 08.10.2015.

<sup>88</sup> Annual Finance Acts and subsidiary Regulations, Customs and Excise management Act 1979, Alcoholic Liquor Duties Act 1979, HMRC Notice No 162 (permitted practices).

<sup>89</sup> Specific excise legislation, 10 June 2010 and products classification laid down in the Finance Act 2003.

<sup>90</sup> Source: AICV, 'Code of Practice', 2015

<sup>91</sup> Draft definitions of 'perry' 'flavoured cider/perry' and 'fruit wine' are also being considered. Since they have not been officially released (yet), they are not explicitly reported in this Study.

concentrate juice.<sup>92</sup> Since the list contains several 'mass-market' products, the adoption of a restrictive definition would be tantamount to expelling the majority of the market out of the cider category. Also various small cider-makers interviewed would be in favour of more restrictive definitions.

The tax differential can be minimal, as in the case of France, moderate (PL, IE and UK) or huge as in the case of Romania (see Table 19 above) where 'traditional' cider is tax-exempt while other OFBs are taxed like Intermediate Products. The actual impact of these measures on excise revenues is however limited in Romania, due to certain enforcement mechanisms. Products coming from another MS that carry the cider CN codes (2206 00 31 or 51 or 81) are *de facto* treated like 'traditional' cider even when they do not meet the domestic criteria for it. In fact, a re-classification of these products would imply challenging the CN code attributed in the country of origin which is not practicable in the absence of a harmonised definition of cider. Eventually, these measures affect only the domestic industry, which is practically non-existent for non-compliant products, since they could not compete with foreign products that have access to the preferential tax treatment.

- **National tax measures.** Certain MS have adopted national non-harmonised taxes targeting specific classes of OFB, variously defined as 'alcopops', 'pre-mixes' and the like. The following examples can be cited:
  - Introduced in 2004, the German alcopop tax was one of the first of its kind.<sup>93</sup> The tax was established within the law for the improvement of the protection of young people from dangers of the alcohol and tobacco consumption, and consisted of an extra duty of EUR 5,550 per hl of pure alcohol, applicable to blends of alcoholic beverages with non-alcoholic beverages between 1.2% and 10% vol that are 'ready-to-drink'. To underline its social orientation, it was established that the revenues from this tax would fund the Federal Centre for Health Education, to finance its addiction prevention activities. The tax addresses spirit-based drinks falling under CN 2208, and is added to the ordinary excise duty levied on ethyl alcohol. Its effectiveness in reducing the consumption of these products is demonstrated by the trends in revenues, which have fallen from EUR 10.0 mn in 2005, to about EUR 1.0 mn in 2014. On the other hand, since CN 2206 alcopops are excluded, this tax caused a major shift of both supply and demand to fermented-base alternatives. The effects of the German alcopop taxes have been analysed in detail in an EU-funded study<sup>94</sup> whose salient results are summarised in Box 3 below.<sup>95</sup>

Similar approaches have been adopted also in Denmark and Luxembourg, both of which apply an additional duty on products containing a mixture of ethyl alcohol and a non-alcoholic drink.

**Box 3 – Impact of the 'alcopop tax' in Germany – summary of the HAPI Study results<sup>96</sup>**

*'(...) The total volume of spirit-based RTDs fell by 74.2% in Germany between 2005 and 2010. In fact the sales of alcopops plummeted so markedly that it had a profound effect on some of the largest retailers of alcoholic products in Germany. However, when considering the annual spending*

<sup>92</sup> <http://www.camra.org.uk/cider-not-recognised-as-being-real>

<sup>93</sup> <http://www.gesetze-im-internet.de/bundesrecht/alkopopstg/gesamt.pdf>

<sup>94</sup> Anderson P., Suhrcke M. and Brookes C., 'An overview of the market for alcohol beverages of potentially particular appeal to minors', HAPI, 2012. Hereinafter: 'HAPI Study (2012)'.  
<sup>95</sup> Also the Ramboll Evaluation observed a steep growth of wine-based RTDs in the past few years, from an estimated 30 mn in 2009 to in excess of 70 mn in 2014.

<sup>96</sup> Source: Excerpts from the HAPI Study (2012).

per capita on RTDs and high-strength pre-mixes (HS), a totally different picture emerges. Although a decline in spending can be observed after the introduction of the alcopop tax in 2004, a steady increase since then has brought per capita annual spending on RTD/HSs of the legal drinking age population to EUR 39, nearly the same amount Germans were spending on RTDs and high-strength pre-mixes before the introduction of the ATL (EUR 40). This suggests that the alcohol industry as a whole responded to the alcopop tax by introducing new RTDs and high-strength pre-mixes that are exempt from the tax. Of the 33 key new product developments in Germany in 2009 and 2010, 14 were new RTDs or high-strength pre-mixes.

The introduction of malt-based RTDs (generally beer-mixes) contributed to the increase on spending on RTDs. With a growth of 41.4% in total volume since 2005, this was the strongest growing RTD type in Germany. Due to their malt or beer base, these beverages do not fall under the term "alcopop" as defined by the alcopop tax. They are therefore a cheaper alternative to alcopops, while being similar in flavour, colouring and marketing. Additionally, the legal age of purchase for beer-based products is 16 years, making malt-based pre-mixes more readily available to a younger consumer group. Since the alcopop tax applied to products with an alcohol concentration of between 1.2% and 10%, a number of high-strength pre-mixes have been introduced as an alternative to alcopops. These include traditional long drinks such as gin and tonic, vodka and cranberry, or rum and coke, as well as a number of pre-mixed cocktails such as canned "mai tais" or ready-to-drink daiquiris and piña coladas. The exotic flavours and the resemblance to popular soft drinks create the same appeal for minors as malt-based RTDs. (...)'

- The French premix tax<sup>97</sup> is more comprehensive than the German alcopop tax in that it is not related to the spirit-base of the drink but to two alternative criteria: (i) the blend of an alcoholic and a non-alcoholic beverage; or (ii) a content of sugar exceeding 35g per litre, or corresponding amount of other sweeteners. The tax applies to products with an ABV comprised between 1.2% and 12%, and amount to EUR 11 per decilitre of pure alcohol. The scope of application has slightly modified overtime to reflect market trends and production practices. The last revision, in March 2016, introduced certain exemptions to the application of the tax to AWP, and expanded the list of sweeteners covered.<sup>98</sup> In 2016, the pre-mix tax yield amounted to EUR 1.4 mn, down from ca. EUR 20 mn since a decade ago. After the initial drop, in more recent years the revenue trend is fluctuating, possibly in relation with periodical review of the scope of application. Interestingly, the French pre-mix tax may apply to alcoholic beverages falling under any CN code except CN 2204 (wine) and CN 2205 (vermouth etc.) products, and in this sense it has possibly contributed to the significant growth of AWP markets of the last few years. The magnitude of the effects of the pre-mix tax are illustrated in Annex 3 of the *Circulaire 16 Mars 2016* of the Ministry of Finance, reproduced in Box 4 below.

#### **Box 4 – Scope and impact of the 'pre-mix tax' in France**

To help to understand the scope of applicability of the tax, the *Circulaire* provides a few examples for each of the two salient criteria. As regards the blend of an alcoholic and a non-alcoholic beverage, examples include:

- a beverage composed of orange juice mixed with vodka, with an ABV of 6.5%;
- a beverage composed of beer (80%) and lemonade, with an ABV of 1.4%;
- a beverage composed of cola mixed with whiskey, with an ABV of 8%;
- a beverage composed of red wine with orange juice, with an ABV of 7%;
- a beverage composed of beer, fruit juice, sugar and aromas, with an ABV of 5%.

The second criterion applies to products that are not compliant with the first criterion, and regards the addition of more than 35g of sugar per litre (expressed as inverted sugars). The concrete examples made are:

- a beverage mostly composed of vodka, orange aroma, colours, sparkling water, and containing 40 g of sugar, with an ABV of 5.5%;

<sup>97</sup> Introduced by Law 2004-806 on public health and codified under Article 1613 bis of the general Tax Code, updated by the Circular of 16 March 2016.

<sup>98</sup> Rebaudioside A has been added.

- a beverage mostly composed of cider, with a 5% addition of cassis liqueur, and containing 65 g of sugar, with an ABV of 4.5%;
- a beverage composed of beer (95%), with a rum addition, and containing 70 g of sugar, with an ABV of 6.5%;
- a beverage composed by an alcoholic fermented beverage, with an addition of sparkling water, aromas, colours, and containing 100 mg/l of aspartame and 150 mg/l of acesulfame K, which correspond to 21 g and 32 g of sugar respectively, with an ABV of 5%.

A simulation of the tax applicable to concrete products is also provided in the *Circulaire* (Table 20 below).

**Table 20 – Simulation of the effect of French pre-mix tax on specific products**

Quantity of products expressed in hl	Rum + fruit juice (CN 2208)	Fermented base + aroma + colours + 55g of sugar (CN 2206)	Cider + vodka + 65 g of sugar (CN 2208)	Beer + water + aroma + 60 g of sugar (CN 2203)
<b>Price before tax</b>	€400	€60	€100	€80
<b>ABV</b>	7%	5.5%	8%	6%
<b>Excise duty</b>	€121.63	€3.77	€139	€44.46
<b>Pre-mix tax</b>	€770	€605	€880	€660
<b>VAT</b>	€258.33	€133.75	€223.80	€156.89
<b>Total tax</b>	€1,149.96	€742.52	€1,242.80	€861.35
<b>Final Price</b>	€1,549.96	€802.52	€1,342.80	€941.35

**Source:** *Circulaire*, 16 March 2016.

- **Criteria to distinguish between CN 2206 and CN 2208.** The last aspect that is important to consider is that the subjective criteria at the basis of the distinction between CN 2206 and CN 2208 may be interpreted differently by customs administrations, leading to possible disparities of approach to similar products across MS, or within the same country over time. The matter is of significant concern for the global industry, as the International Federation of Wine and Spirits (FIVS) clarified in the aftermath of the HSC adoption of decision NC1500E1a on admitting cleaned-up fermented beverages under CN 2208. FIVS wrote: *'The Draft EN Amendment would create enormous uncertainty surrounding classification of products that do not go through distillation, particularly intermediate fermented alcohol products, opening the door to conflicting determinations among Members regarding the classification of fermented products that have gone through some degree of purification, including products that to this point have uniformly been classified as fermented products.'*<sup>99</sup> One of the underlying studies forecast market disruptions, trade issues, enforcement problems and other difficulties stemming from this approach.<sup>100</sup>

Member States have generally taken cautious approaches towards the translation of CJEU criteria and CNEN note 2206 00 into classification practices. Based on interviews with customs authorities, the subjective criteria of taste, smell and appearance have been often addressed introducing a certain degree of objectivity in the assessment methods, in particular through laboratory analysis of the concentration of certain by-products of fermentation in order to establish the prevalent character of the product. In some cases, this is accompanied with an increased 'professionalisation' of the classification process: with some MS having established *ad hoc* 'task forces' for it. In parallel, administrations encourage the collaboration with industry and in particular the preliminary submission of product samples and dossiers for a classification opinion. Nearly all the competent officers interviewed on this point affirmed that with the current definitions and notes the distinction between CN 2206 and CN 2208 remains however not fully clear.

<sup>99</sup> Source: <https://fivs.org/resources/virtualLibrary.htm?a=report&start=0&documentIds=495>

<sup>100</sup> FIVS, 'When is a Fermented Beverage not a Fermented Beverage?' 05.08.2010.

While the above processes have reportedly reduced the risk of classification disparities within the same country (as confirmed *inter alia* by various economic operators and trade associations), it has evidently not eliminated the risk of inconsistencies across MS, due not only to different views and criteria employed, but also to the specificities of certain markets (customs laboratories' priorities varies across MS) and, evidently, the analytical methods and technologies used. In this sense, certain MS are seemingly more conservative with respect to CN 2208 definition and apply it essentially to distilled products, while others are more likely to use it also for cleaned-up fermented beverages and mixtures. Of the sample MS analysed, it is interesting to cite the case of France that has adopted at the end of 2016 a circular stating explicitly that cleaned-up fermented bases, and the beverages made from them, should be treated as spirits.<sup>101</sup>

To reduce legal uncertainty, and prevent the risk of fines for misclassified products already on the market, economic operators make frequently recourse to Binding Tariff Information (BTI) decisions. But since, as seen, criteria and methods vary across MS, the outcome of a BTI may also vary, and products with similar characteristics may eventually be treated differently. A review of the BTI descriptions available in the EBTI database returned some evidence of such disparities of approach. A few possible examples are reported in Box 5 below.<sup>102</sup>

<b>Box 5 – Review of selected BTI decisions (from the EBTI database)</b>	
<b>Case 1 – Fruit-wine based alcoholic beverages with addition of ethyl alcohol</b>	
The UK classified as 2206.0059 (still other fermented beverage other than cider and perry) a mixture of cider (obtained from the fermentation of apple juice and sugar) and water, sugar, citric acid, fruit flavours, colours and preservatives, fortified with the addition of ethyl alcohol to bring the strength up to 21.9%.	Poland classified as 2208.9069 (other spirituous beverages) a mixture of fruit wine (obtained from the fermentation of an unspecified fruit concentrate and glucose syrup) and water, colours and flavours, fortified with the addition of ethyl alcohol to bring the strength up to 21%.
<b>Case 2 – Fruit-wine based alcoholic cream</b>	
The UK classified as 2206.0059 (still other fermented beverage other than cider and perry) a 'country cream' obtained by mixing fermented apple wine with cream, with a 14.8% vol.	Ireland classified as 2208.7010 (liqueurs and cordials) a 'country wine based cream', with a 14.9% vol.
<b>Case 3 – Wine-based ready-to-drink</b>	
Germany classified as 2206.0039 (sparkling other fermented beverage other than cider and perry) an aromatised wine-based drink made of: wine (white wine or rosé wine), demineralised water, inverted sugar syrup, citric acid, lactic acid, sodium benzoate, flavourings, colours, sulphur dioxide, and carbon dioxide, with an alcohol content of 5% vol.	The Netherlands classified as 2208.7010 (liqueurs and cordials) an aromatised wine-based drink made of: wine, sparkling water, syrup, citric acid, and natural flavours, with an alcohol content of 5%, due to the fact that – after the addition of water, sugar and flavourings – the 'character of wine had been lost'.
<b>Case 4 – Flavoured fortified wine</b>	
In 2011, Ireland classified as 2208.9069 (other spirituous beverages) a fortified wine blended with sugars, flavours and colours.	A few years later, in 2014, Ireland classified as 2206.0059 (still other fermented beverages other than cider and perry) a fortified wine infused with

<sup>101</sup> Circulaire 22.12.2016.

<sup>102</sup> Part of the examples reported were suggested in the report prepared for the Polish Council of Wine by Parulski & Wspólnicy, 'Tariff and Excise Tax Classification of Fermented Beverages – Issues of Concerns', September 2016. The report shows that certain products that in Poland are classified as 2208 are very similar to other products that other MS classifies as 2206.

botanical roots and citrus.

**Source:** Author's review of EBTI.**Note:** The Author did not have access to the full information on the BTI decision but only to the publicly-available section. It is therefore possible that some of the examples reported here are in fact only apparent similarities. At the same time it is possible that other similarities could not be detected due to the scarce amount of public information available for certain dossier.

### ➤ ESTIMATED TAX REVENUE FROM OFB

Finally, in order to appreciate the relative magnitude of the impact of classification issues, we have estimated the overall excise duty yield from the various product categories, and its overtime evolution vis-à-vis market trends.

The overall tax revenue collected from OFB has to be extrapolated from aggregated data since, as discussed, OFB and wine share the same excise product code (EPC) that is used to move products and pay excise duty. So the Excise Duty Tables (EDT) compiled by DG TAXUD do not distinguish between wine and OFB, and the same goes with tax revenue data collected by national tax authorities. It is possible that customs may be able to provide more accurate estimates based on CN monitoring data, but this reportedly requires major efforts and the results would not be exempt from uncertainties. On the other hand, MS often apply the same rate to wine and OFB and this greatly facilitates to disaggregate the respective revenue amounts using the IWSR market estimates. Another complication in this exercise is represented by the different rates that exist between still and sparkling products, which can be only partly dealt with through IWSR market data, since such level of granularity for OFB is not provided. Finally, the MS-level excise duty structure is made more complex by a series of special treatments, such as reduced rates, sub-categories, differentiated 'tax-bands' that make unfeasible a full reconciliation between the tax revenue that can be predicted based on sales data, and the actual aggregated revenue reported in the EDT.

Table 21 below shows the overall trends in the excise duty collected at EU level, also disaggregated by category on the basis of our estimations.<sup>103</sup> Overall the excise duty revenue from alcoholic beverages has increased from EUR 29.6 bn in 2010 to EUR 35.6 bn five years later. In the same period, the amount of sales in litres has slightly decreased, while the overall market value has moderately grown. The increase in tax revenues was driven especially by OFB (+8.3% / year on average) and, to a smaller extent, by wine. In absolute terms, OFB remains the second smallest category for tax revenue after Intermediate Products. It contributes to less than 7% of the total revenue (with high variance across MS), against 16.2% of wine, 31.4% of beer, and 43.4% of ethyl alcohol.

**Table 21 – General EU trends in excise duty revenues vis-à-vis market trends, and by product category (2010-2016)**

	2010	2011	2012	2013	2014	2015	2016	CAGR
Volume (bn litres)	53.75	53.91	53.31	52.47	52.22	52.20	52.40	-0.42%
Value (€ bn)	185.44	188.31	192.17	190.73	194.84	203.91	207.20	1.87%
Tax Revenue (€ bn)	29.64	30.64	32.08	32.44	34.45	35.57	N/A	3.71%

<sup>103</sup> The exercise requires to disaggregate MS tax revenue data among all pertinent sub-categories applying the ratio derived from market data (appropriately weighed by the excise duty rate applied). Then, MS-level disaggregated revenue data (for all EU28) have been summed up to obtain the EU-level estimates by product categories. A certain margin of error in the attribution of revenues to OFB and Wine is possible, as a result of the complex disaggregation exercise.

Revenue share by excise duty category								
Beer	31.1%	30.9%	31.0%	31.1%	32.2%	31.4%	N/A	3.9%
Wine	15.0%	15.1%	15.1%	15.5%	15.6%	16.2%	N/A	5.3%
OFB	5.6%	5.9%	6.0%	6.2%	6.7%	6.9%	N/A	8.3%
IP	2.3%	2.2%	2.2%	2.1%	2.0%	2.0%	N/A	0.4%
ET	45.9%	45.9%	45.6%	45.0%	43.5%	43.4%	N/A	2.6%

**Source:** Author's elaboration of IWSR data, EDT series and other qualitative sources.

**Note:** the revenue share by category was calculated disaggregating at country level (for all MS28) the amount of duty paid by individual categories, based on IWSR sales data (in litres) and the rate applicable in a given year.

**Legend:** OFB: other fermented beverages; IP: intermediate products; ET: ethyl alcohol.

## 2.1.5 Problem analysis

The problem areas identified in the framework of the REFIT process and defined in the inception phase of this Study are reviewed in this Section in the light of the evidence and results of the baseline assessment. The purpose is twofold: (i) on one hand, to provide our estimates on the actual magnitude and prospect of existing issues; (ii) on the other hand to define the problem drivers and likely impact areas (intended and unintended) that will support the formulation of policy options and the structuring of the impact assessment (see Section 3.1). In particular, three problem areas are analysed, of which the first is the most substantial, while the others are of more limited importance, namely:

- 1) the uncertain scope of the category 'Other Fermented Beverage';
- 2) the unclear application of the 'entirely fermented origins' provision to beverages containing alcohol as a flavour-carrier;
- 3) the indefinite excise product code for wine and OFB.

### 2.1.5.1 Uncertain scope of the category 'Other Fermented Beverages'

#### ➤ THE PROBLEM TREE

There is room for uncertainties and disparities in the interpretation of the tax categorisation rules laid down in Directive 92/83/EEC in relation with the HS / CN coding system. As a consequence similar products may fall in different tax categories of the excise system depending on the criteria used by the competent authority of different MS. In principle this may require lengthy and costly classification efforts that may eventually result in disputes.<sup>104</sup>

As discussed at length in the previous Section, these problems are concentrated in the areas of 'other fermented beverages' as defined under CN 2206, and its uncertain boundary with CN 2208. As this category is taxed more favourably than intermediate products or ethyl alcohol, there could be an incentive to develop and commercialise 'borderline' products that take advantage of the existing ambiguities and disparities of views across MS. This may involve seeking for favourable BTIs in one MS to ensure the product classification is not questioned in other MS. The issue primarily stems from the development of new types of 'borderline' product mixing alcohol of different origins or using 'cleaned-up' fermented alcohol, in order to gain a competitive advantage over other types of product. This practice has potential consequences on the amount of excise duty revenue collected and possibly on the overall affordability of alcohol, including by protected categories of consumers.

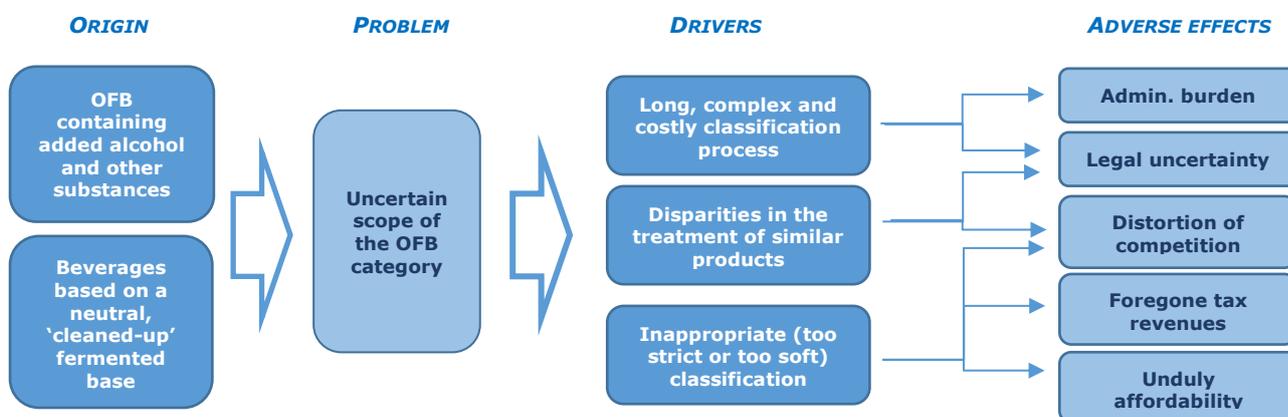
<sup>104</sup> As discussed in Box 1, there is also an administrative issue with Article 26 of the Directive, which prescribes to make reference to an outdated version of the CN codes. However, the matter is not a source of practical problems or market distortion so it was not included in the scope of this Study.

The categories of products potentially containing 'borderline' products are, as seen, mixed drinks of various ABV strength, certain 'borderline' cider products, and medium-high strength fermented beverages with characteristics similar to certain liqueurs and spirits. In this sense, 'borderline' products can be found both in the fiscal category of OFB (Article 12) and in the fiscal category of IP (Article 17), the latter being *de facto* fermented beverages other than wine and beer that do not fit into the Article 12 definition.

The landmark rulings of the CJEU established the possibility of classifying these products under CN 2208 and this gave MS a tool to tackle opportunistic practices and the risk of tax losses. On the other hand, the subjectivity of the criteria identified to distinguish borderline products from genuine OFB has possibly magnified the classification uncertainties.

The above narrative summary of the problem can be represented with the causal model displayed in Figure 1 below.

**Figure 1 – The problem tree of classification issues**



➤ **GENERAL DYNAMICS OF THE ALCOHOLIC BEVERAGE MARKET**

To estimate the nature and the magnitude of the adverse effects potentially caused by the above classification uncertainties, it is necessary to consider at first the dynamics of the alcoholic beverage markets, including both the supply and the demand side. Needless to say, the mechanisms underlying this market are highly complex and the dynamics vary across market segments – in terms of both 'type' of beverage and price segment – and across geographical markets (i.e. consumption habits and consumer preferences).

This Section reviews in particular: (i) the mechanism of substitution across products and its connection with price levels; (ii) the effects of excise duty and its variation on consumer prices; and (iii) the possible general correlation between tax level, affordability and demand/consumption. We have examined these mechanisms through an econometric analysis based on a combination of IWSR market data with tax levels and revenue data (Excise Duty Tables), also integrating other variables drawn from Eurostat and WHO GISAH. We have triangulated our results with the results of similar exercises from the economic literature, and with the qualitative assessments collected from the stakeholder consultation.

- **Cross-product substitution.** This is conventionally measured through the 'cross-price elasticity'. When this variable is positive, products are substitutes and the increase of price in one category results in an increased consumption of another

category. When values are negative, products are complementary and follow the same trends (possibly influenced by an external third factors). When the correlation is not statistically significant, the analysed products are probably independent of each other.

The latter is frequently the outcome that can be found in the literature that tried to examine the cross-price elasticity of alcoholic beverages, which generally returns inconclusive and statistically weak evidence (see Box 6). In practice, no clear and robust substitution effect induced by price variations can be observed. In fact, substitution can be more substantially driven by factors other than price, and connected to: socio-demographic and lifestyle changes, marketing strategies, awareness-raising campaigns, national regulatory frameworks on labelling, commercialisation, and drinking etc. The list of variables can be very long and differs across contexts, so eventually the economic research has progressively abandoned the econometric approach based on cross-price elasticity. Moreover, it has been observed that price levels of different categories of products are often positively correlated. When prices fluctuate coherently for all products and nonetheless the level of demand varies, this would further confirm that consumption patterns, including substitution across products, is prevalently determined by other factors.

**Box 6 – Selected excerpts from the literature review on cross-price elasticity for alcoholic beverages**

A first review of estimates of cross-price elasticities in alcoholic products conducted in early 2000s<sup>105</sup> showed a wide range of estimates of different sign, implying disagreement on whether beer, wine and spirits are complements or substitutes, and stressed the importance of extraneous factors, such as changes in consumer tastes and preferences. Still, the report concluded that the balance of evidence suggests that the drinks are substitutes, although cross-elasticities estimates have to be regarded with caution.

More recently, Meng *et al.* (2014) attempted to estimate the cross-price elasticities of off- and on-trade beer, cider, wine, spirits and ready-to-drinks in the UK by applying a pseudo-panel approach to the cross-sectional data on private households' expenditures.<sup>106</sup> Only 6 out of 90 estimated cross-price elasticities were statistically significant and the suggested substitution and complementary relationships were very difficult to explain (46 estimates had a positive signs and 44 a negative one).

A new study using cross-sectional data from the 2013 Australian arm of the International Alcohol Control survey employed a Tobit model approach to estimate cross-price elasticities of 11 categories of beverage, comprising on- and off-premise separately for regular beer (full strength), low-mid strength beer, bottle wine, spirits and ready-to-drinks, and off-premise cask wine.<sup>107</sup> A significantly, positive relationship was detected between the prices of off-premise beverages with demand for the same beverage on-premise, while the cross-price elasticities among different beverage categories provided again indecisive results: very few statistically significant estimates (8 out 100) and a mix of positive and negative signs (49 and 51, respectively).

Given the above challenges, other studies on excise duties on alcoholic beverages excluded cross-price effects, which were regarded of secondary importance to the own-price effect.<sup>108</sup>

We have tested the cross-price elasticity for our 'borderline' categories of products, through a variant of the model used to estimate the own-elasticity of individual categories of product. In particular, we have tried to estimate if and how mixed drinks, 'borderline' ciders, and 'borderline' IP showed clear substitution correlations with other products. In some cases, a very small complementary correlation was registered, suggesting that other factors (such as the effect of the economic crisis,

<sup>105</sup> Custom Associates Ltd, 'Study on competition between alcoholic drinks', 2001.

<sup>106</sup> Meng, Y. et al., 'Estimation of Own and Cross Price Elasticities of Alcohol Demand in the UK. A Pseudo-panel Approach Using the Living Costs and Food Survey 2001-2009', *Journal of Health Economics*, Vol. 34, 2014.

<sup>107</sup> Jiang H. J., Livingston M., Room R., Callinan S., 'Price elasticity of on- and off-premises demand for alcoholic drinks: a Tobit analysis', in *Drug and alcohol dependence*, 2016.

<sup>108</sup> London Economics (May 2010), *Study analysing possible changes in the minimum rates and structure of excise duties on alcoholic beverages*.

the introduction of certain national regulations, the impact of information campaign etc.) might have simultaneously influenced the level of consumption of different product categories, regardless of price. Overall, the outcome was not statistically significant, so no substitution could be demonstrated.<sup>109</sup>

The above considerations should not be interpreted as a denial of the substitutability of all alcoholic beverages. In fact, this assumption is *inter alia* confirmed by certain marketing strategies, which increasingly abandon the approach 'per class of product' to adopt the 'per consumption occasion / modality' perspective (aperitif, refreshment, RTD, etc.). These complex marketing mechanisms, and their degree of success in moving consumers from one type of beverage to another, are outside of scope of this Study. For the purpose of our analysis, the key message is that a certain level of cross-products substitution cannot be systematically predicted by a variation in price.

- **The impact of excise duty on demand.** From the above it derives that excise duty – that is one of the determinants of price – cannot have a statistically-significant correlation with cross-product substitution. In other words, at a systemic level, we have not observed a clear relationship between the tax rate applied on the target classes of products and the level of consumption of competing products. This statement requires two important qualifications: (i) despite the lack of a general relationship, under specific circumstances the variation of excise duty level can still have profound market effects; and (ii) as the results of our model show, despite the lack of a robust estimate for the cross-price elasticity, the 'own-elasticity' of specific categories of products can be estimated with a certain degree of precision.

With regard to the first point, the introduction of the 'alcopop' tax in Germany is a classical example of how taxes can indeed have a profound impact on substitution. This case, described in more detail in Box 7, was evidently caused by the very high level to which the tax was set and the fact that other potentially competitive products (malt and wine-based mixed drinks) were not targeted. However, in various other circumstances a significant increase of the excise duty applied to a specific category did not necessarily lead consumers towards other products. For instance, in 2013, the excise duty on beer in France increased by 160%, but the volume of sales continued to grow and no relevant changes were observed in other product categories.<sup>110</sup>

**Box 7 – Possible substitution effects induced by the introduction of the 'alcopop tax' in Germany**

Useful insights on substitution effects between different alcoholic products can be drawn from the review of the consumption trend of alcoholic beverages in Germany between 2000 and 2007. In the first three years of years 2000s, mixed drinks grew in popularity and their consumption recorded an impressive growth (about 78% per year, on average), which partly offset the decline in the volumes consumed of beer and spirits.

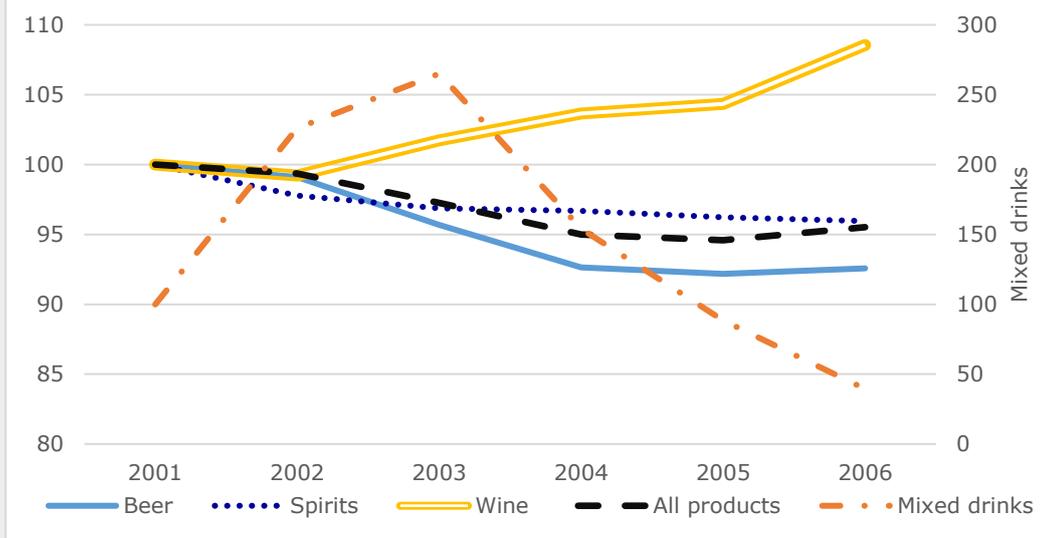
<sup>109</sup> The very high correlation between prices across categories of product, which inflates the standard errors in multiple regressions (the 'multicollinearity' issue), and the fact that the model leaves out several independent, explanatory variables (the so called, 'omitted variable bias') do not allow firm conclusions about cross-price elasticities to be made. In the statistical model with fixed-effects at the product level, which allows for the controlling of time-invariant unobserved heterogeneity (e.g. consumer preferences across products stable over time), ten out of 16 cross-price elasticities were statistically significant. However, this model is weak in dealing with time-variant unobserved factors at the product level (e.g. changes in consumer tastes over time that are different across product categories) and the results might be biased. Indeed, the statistical significance disappears when the HAC standard errors (heteroscedasticity and auto-correlation robust standard errors) are used, which allows accounting for serially correlated errors likely due to the previous omitted factors (e.g. consumer preferences across product categories that slowly change over time).

<sup>110</sup> There have been changes in the excise duty levels of other products as well but very modest and on a much smaller scale than for beer.

After the introduction of the alcopop tax in July 2004, consumers and the market responded negatively, and a major decline in consumption was recorded – i.e. amounting to some 50% per year between 2004 and 2006. Looking at the trend in consumption of other beverages, it seems that some previous drinkers of mixed drinks switched to beer as indicated by the slowing down of its declining rate (see Figure 2 below).

The existence of a similar substitution effect has been confirmed by a study conducted in 2010 to assess the effects of the alcopops tax on alcohol consumption and beverage preference among adolescents in Germany.<sup>111</sup> Based on 2003 and 2007 data from the cross-sectional survey of the European School Survey Project on Alcohol and other Drugs (ESPAD), the study confirmed a partial substitution of alcopops by spirits and beer among 12–17-year-olds.

**Figure 2 - Indexed consumption of alcoholic beverages in Germany (in '000 hectolitres, 2001-2016)**



**Source:** Author's elaborations on IWSR data.

**Note:** For better readability the trend of mixed drink is displayed on a separate scale (right vertical axis).

Secondly, the results of our econometric analysis allowed us to estimate with sufficient degree of reliability the impact of excise duty variations on the demand of certain target categories of products. The exercise required two steps. The first step consisted in estimating the 'pass-through' effect of taxes on price, i.e. the average change of price level caused by a variation of excise duty rates (inclusive of the VAT on the excise duty). The impact on prices resulted more than proportional in the case of 'borderline' IP, cider, as well as various other non-target products;<sup>112</sup> it is instead less than proportional for most of the IP products analysed and spirit-based mixed drinks.<sup>113</sup> In the case of mixed drinks with a fermented base the relation observed is not statistically robust, i.e. it is not possible to predict the effect on price of a variation in the excise duty rate. This result is not surprising, given the generally short life-cycle of these products and the importance played by marketing strategies. So, for analytical purposes we have assumed a conventional pass-through rate of 1 (i.e. a 'full pass-through').

The second step consisted in estimating the own-elasticity of the demand for the target categories of product, which in a nutshell is a measure of the variation of

<sup>111</sup> Muller S, Piontek D, Pabst A, Baumeister SE, Kraus L., Changes in alcohol consumption and beverage preference among adolescents after the introduction of the alcopops tax in Germany. *Addiction* 2010; 105:1205–13.

<sup>112</sup> An increase by one EUR in the excise duty per litre has been estimated to translate into a change of the retail price per litre of EUR 1.33, EUR 1.73, and EUR 1.14 for 'borderline' IP, 'borderline' ciders, and various other non-target products, respectively.

<sup>113</sup> The pass-through factor has been estimated at EUR 0.65 and EUR 0.28 for IP products, such as fortified wines and vermouths, and spirit-based mixed drinks, respectively.

consumption expected when the price changes. Predictably, in all cases analysed the model returned negative coefficients, i.e. an increase in price would determine a reduction in the demand. Certain categories like 'borderline' IP and mixed drinks with a fermented base turned out very elastic, with the estimated drop in consumption much greater than the corresponding price variation. In some cases, the statistical robustness of the coefficient was lower, including for mixed drinks, so a certain variability exists in the reaction of consumers to price change, which can be again explained by exogenous factors like the impact of marketing and the volatility of these products.<sup>114</sup>

- **Tax, affordability and consumption.** According to the World Health Organisation (WHO) database, the total alcohol per capita<sup>115</sup> consumption in Europe has decreased by -10.4% from 2007 levels. This trend is confirmed by the decline in the sales of alcoholic beverages per capita in the EU that we have estimated based on IWSR data.<sup>116</sup> Accordingly, a decline of -4% was registered between 2010 and 2016, with an annual average reduction of about -0.7%. This reduction can be barely ascribed to a reduced average affordability of alcoholic beverages. The share of disposable income needed to purchase a fixed bundle of alcoholic beverages remained largely stable, recording a marginal increase from 1.73% in 2010 to 1.77% in 2015.<sup>117</sup> The reason behind the stability of this ratio is that the average income growth in that period (+2.4% annually) largely kept pace with the average growth in the price level of alcoholic beverages (+2.8% annually).

Using a more accurate measure of the affordability, which considers how the price of alcohol has evolved as compared to the price of all other consumers' goods, i.e. the Relative Alcohol Affordability Index (RAAI)<sup>118</sup>, the relationship between affordability and consumption is even weaker. As shown in Figure 3, the RAAI has risen over the last decade, driven by higher disposable income, whereas the indexed consumption declined, in an apparently unrelated manner.

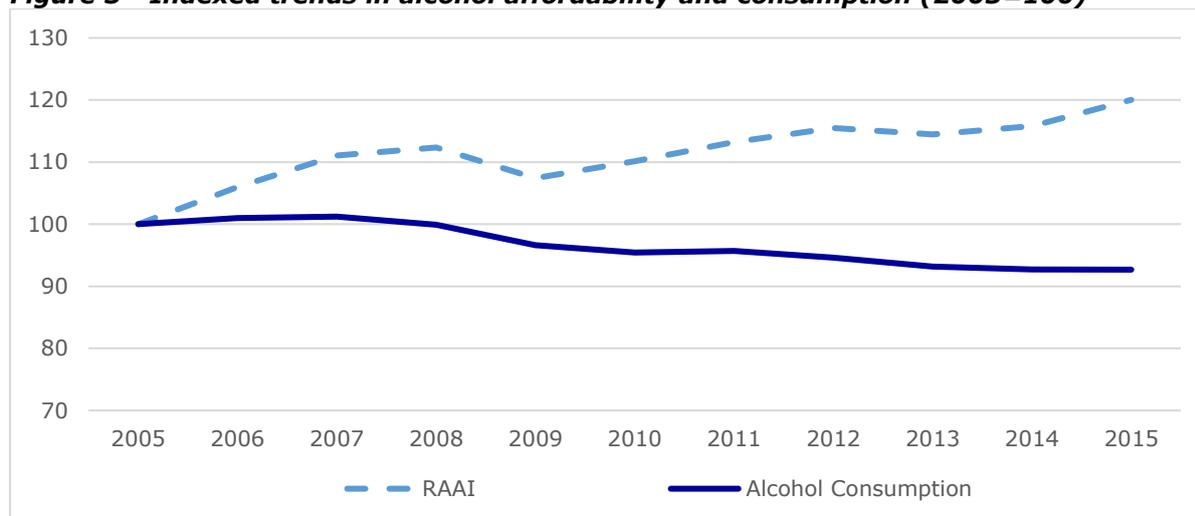
<sup>114</sup> Own-price elasticities for different groups of alcoholic beverages have been estimated by applying two common techniques for panel regressions, i.e. pooled 'ordinary least squares' (OLS) and 'fixed effects'. Estimates achieved for different types of beverages, which have to be interpreted as the percent change in demand resulting from a 1% increase of their retail price, are the following: -1.15% and -2.99% for mixed drinks with a fermented base; (ii) -2.45% and -2.47% for 'borderline ciders', (iii) -1.74% and -3.23% for 'borderline' IP, (iv) and -1.51% and -1.77% for other non-target products. A comparatively lower degree of statistical significance was found in the case of OFB groups of product; thus, in the case of 'borderline' ciders, the lower end of the range has been set at 1.3%, in line with the findings of the existing empirical literature (see, Stockwell, T.M. et al. (2012), 'Does Minimum Pricing Reduce Alcohol Consumption? The Experience of a Canadian Province', *Addiction*, Vol. 107, pp. 912-920; and Meng, Y. et al. (2014), 'Estimation of Own and Cross Price Elasticities of Alcohol Demand in the UK. A Pseudo-panel Approach Using the Living Costs and Food Survey 2001-2009', *Journal of Health Economics*, Vol. 34, pp. 96-103).

<sup>115</sup> According to WHO, alcohol per capita (15+) consumption of pure alcohol is calculated as the sum of beverage-specific alcohol consumption of pure alcohol (beer, wine, spirits, other) from different sources. It is measured as litres of pure alcohol per person per year.

<sup>116</sup> The per capita consumption is calculated as the ratio between the total volume of alcohol in litres consumed across Europe (from IWSR) for each category and the total national population (from Eurostat).

<sup>117</sup> The bundle of alcoholic beverages is based on the per capita consumption of the five main categories of alcoholic beverages consumed in 2010 in EU, which included: (i) 70 litres of beer, (ii) 28 litres of wine, (iii) 5 litres of spirits, (iv) 0.6 litres of mixed drinks, and (v) 2 litres of cider.

<sup>118</sup> We have used here the definition of the index provided by the UK National health Service (See: NHS Information Centre, 'Statistics on Alcohol England, 2017 - Appendices', the NHS Information Centre). The index has been recalculated at EU-level, based on the Eurostat's harmonised indices of consumer prices and adjusted gross disposable income of households.

**Figure 3 - Indexed trends in alcohol affordability and consumption (2005=100)**

**Source:** Author's elaboration based on IWSR data (alcohol consumption) and Eurostat (harmonised indices of consumer prices and adjusted gross disposable income of households).

There are evident limitations to this analysis, namely: the fact that it looks only at broader systemic trends, it does not distinguish among specific socio-economic groups, and it does not distinguish specific 'niches' of products that might have become significantly more affordable (e.g. the renowned issue of 'white cider' in the UK).<sup>119</sup> A micro-level perspective would be more informative in this respect, but at that level it is national/regional and not EU policies and measures that matter. So, for the purpose of estimating the impact attributable to Directive 92/83/EEC, the systemic-level analysis seems more pertinent.

The statistical analysis of the relationship between RAAI and per capita consumption suggests a positive relation, but with a small coefficient. In a nutshell, assuming all other factors neutral, a 1% decrease in alcohol consumption may require a 7% decrease in the affordability index. Under the strong assumptions that: (i) households' disposable income grows at the same rate as the past 10 years (about 2% per year, on average), and (ii) the alcohol prices grow at the same pace of other consumables goods, such a leap in the affordability index would require an increase of the alcohol price by about 10%. Based on the IWSR data, the gross average price of alcoholic beverages in 2016 was about EUR 3.90 per litre, thus, a 10% increase will translate into an average increase in absolute terms of about EUR 0.40 per litre. With a conservative pass-through of excise duty on price equal to 100%<sup>120</sup>, and considering that the average excise duty levied on alcoholic beverages is EUR 0.68 per litre<sup>121</sup>, such effect on price would require a simultaneous increase of the excise duty rates by 57% (across all products in all MS).

Historically, there are no known examples of comparable tax increases ever applied to the entire alcoholic beverage market, so there is no case-study evidence of the collateral effects of a similar fiscal measure. So, the above should be considered as a purely

<sup>119</sup> <https://www.theguardian.com/lifeandstyle/2011/apr/17/cider-industry-protected-expense-alcoholics>

<sup>120</sup> Our estimates of pass-through factor for different categories of beverages are typically higher than 1. These results are corroborated by the literature review. For instance, Sassi F. et al. (2103) conclude their meta-analysis of tax pass-through across different types of alcoholic beverages stating that: '[g]enerally, alcohol taxes are more than fully passed through to prices.' (see, Sassi F., Belloni A., Capobianco C., 'The Role of Fiscal Policies in Health Promotion', OECD Health Working Paper No. 66, 2013). According to a recent study commissioned by DG SANTE pass-through coefficients appear more mixed across MS (see: Rabinovich, et al., 'Further study on the affordability of alcoholic beverages in the EU - A focus on excise duty pass-through, on- and off-trade sales, price promotions and pricing regulations', RAND Europe, 2012).

<sup>121</sup> This value is based on the ratio between the total EU 28 revenue from excise duty on alcoholic beverage (EUR 35.6 bn) and the total volume of litres consumed (about 52 bn).

theoretical simulation whose main purpose is to show how moderate tax increases would only marginally affect overall consumption, at systemic level.<sup>122</sup>

The implication for our Study is that since the 'borderline' products have negligible impact on the affordability of alcohol (in systemic terms), they are unlikely to represent a huge threat to the general public health policy on alcohol control. Of course, at local level, certain 'borderline' products may constitute a social problem (e.g. too affordable or appealing to young people and vulnerable social categories), and in this sense they call for localised solutions, as has happened already in various MS.

➤ **INCENTIVES CREATED BY TAX RATE DIFFERENTIALS**

A certain degree of substitution across different categories of products is, as discussed, a natural market dynamic that is related both to price levels and other factors. The excise duty level generally influences the price level, so it can be argued that a certain market configuration reflects, in part, the objective of tax policy.<sup>123</sup> While this can be true at macro level, we have seen that the relation between tax and price is less evident at the micro level, and a smaller variation of the former is not always consistently reflected on the latter.

So, assuming that a certain diversity of tax treatment across product categories is not *per se* discriminatory but the consequence of legitimate tax policy decisions, it remains to establish when a certain product is unduly taking advantage of a more favourable tax treatment causing unintended tax-induced substitution and distortion of competition. This analysis requires obviously a much thinner granularity than the overall cross-substitution analysis described above and implies to look at the tax environment of specific MS, in order to identify the existence of sufficient incentives to pursue tax optimisation strategies.

In other words, the pre-condition for tax-induced market distortion is that there exists a conspicuous tax differential across the different categories in a specific (geographical) market. In other words, 'borderline' products developed for tax optimisation purposes can arguably be found in geographical markets and within specific segments where there is a tax-saving incentive that clearly outweighs the production and marketing costs. This pre-condition is far from being obvious: first of all, it is generally acknowledged that - with due exceptions - the production costs of beverages with a predominant fermented base are higher than for a standard distilled-base beverages; secondly, the 'borderline' products at stake typically compete in the low-price segment where margins are very thin, and production costs are a relevant factor.

We have developed synthetic diagrams to illustrate in a comparative perspective the tax rate applicable to the different types of product, in the six sample MS (Figure 4). As the tax differential changes with the strength (wine, OFB and IP are taxed per volume of finished product, while beer and ethyl alcohol by ABV/ Plato degree) the diagrams

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<sup>122</sup> In principle, the whole matter can be seen the other way round, i.e. a simultaneous, significant reduction of tax rates may induce an increase (or slower decrease) in the overall per capita alcohol consumption. This assumption is certainly compatible with the results of our Study as well as of other researches that investigated the link between taxation and demand (a relationship that is always mediated by the actual effects on retail prices). Some qualifications are nonetheless necessary: (i) the dependent variable in the above simulation is the consumption of 'pure alcohol', so the conclusions cannot be immediately extended to specific categories of product, especially products with a generally low ABV like beer, cider etc.; (ii) in particular, the reduced rates applicable in some MS to low-strength products may encourage the consumption of greater quantities, but this does not necessarily translate in an increase consumption of 'pure alcohol' (see Section 2.4 for details); (iii) the simulation regards a generalised variation in the price level, not only a segment of the market (as it is for instance the case with reduced rates for small producers, which - as discussed in Section 2.3 - concerns only a fraction of the overall EU market of alcoholic beverages).

<sup>123</sup> So, there are countries where wine is taxed lower than beer and *vice versa*.

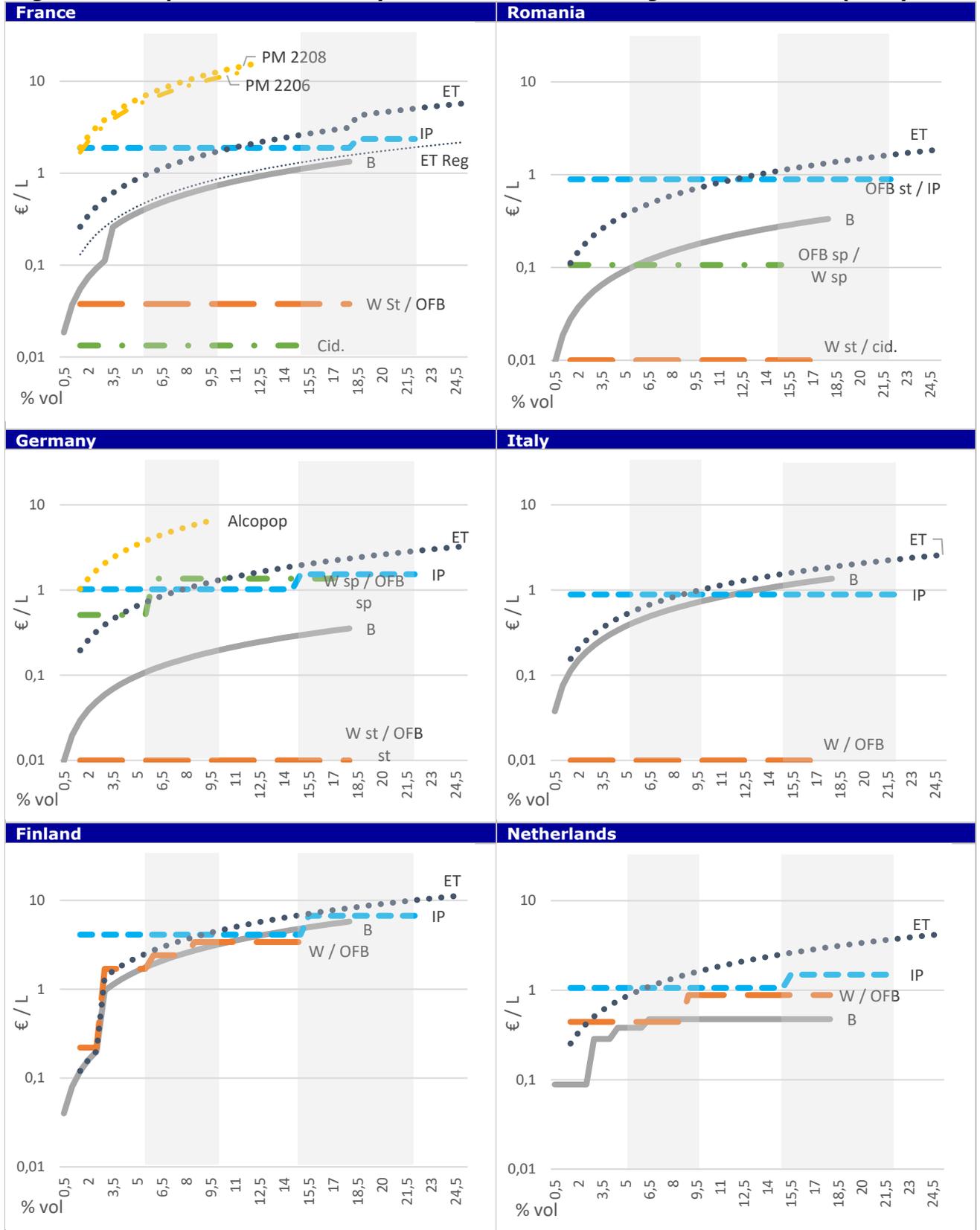
display the tax level on a continuum of ABV values. The analysis of the diagrams allows a few observations:

- Tax differentials vary significantly across MS. They are quite spread out, for instance in DE and FR, and much more compact in FI and NL, where there seems to be limited incentives for cross-over products.
- However, more important is the differential between the specific categories at stake, i.e. OFB, IP and ET. In the first case, high differentials can be observed in MS with a zero rate on OFB (IT, DE, RO for 'traditional' cider) and to some extent in FR. Interestingly, in NL and FI, the excise rate applicable in the 'critical' 10%-15% vol band coincides.
- The IP and ET lines intersect between 6.5% (NL) and 12.5% (RO). Before the intersection point, IP are taxed more heavily than ET and *vice versa*. Since IP below 10% are rare it is fair to say that ET are always more taxed than IP, but some countries (FR, DE, FI, and NL) have partly bridged the gap by introducing reduced rates below a certain ABV. In FI and DE, the gap seems particularly small.
- The differential between OFB and ET – which is particularly relevant for low-strength mixed drinks – is quite equally high in FR, DE, and IT. In FI there is virtually no difference; in NL the difference is small; in RO 'generic' OFB may be taxed much more heavily than ET in the low ABV band. Moreover, it has to be noted that where the gap is high (FR and IT) there are national measures in place (the pre-mix tax in FR and the Article 17(2) option in IT) partly reducing the tax advantage. In DE, where the alcopop tax tackles only spirit-based RTDs, there is a clear big incentives for malt-based or wine-based alternatives.
- At medium / high ABV levels there seems to be generalised tax incentives that are more marked just below 15% (between OFB and IP) and just below 22% (between IP and ET). At lower ABV levels, the tax incentive for mixed drinks is less clear-cut. If any, it seems more marked just below 5% ABV.

In conclusion, we should remind that tax differentials are not the only type of regulatory-driven incentives and are possibly not the most important. Other national measures concerning advertising, distribution etc. may play a major role. Two examples are worth mentioning here, especially since they come from MS with limited tax differential incentives:

- (i) In the Netherlands alcoholic beverages with an ABV greater than 15% can be sold only in authorised liquor shops and not in the mass distribution retail channels. The diffusion in the country of low-price 'licorettes' with an ABV of 14.5% may therefore be to some extent motivated by this national policy rather than / in addition to possible fiscal advantages.
- (ii) Similarly, in Finland fermented (and not distilled) alcoholic beverages below 4.7% vol can be sold off-trade in grocery stores and other retail outlets. Above this threshold, they can be sold only through the State monopoly (Alko) or on-trade in licensed premises. The market share of these products against the other beverages is the highest in the EU.

**Figure 4 – Comparison of excise duty rates on alcoholic beverages in selected MS (2017)**



**Source:** Author's elaboration of EDT series.

**Note:** The vertical axis is represented on a logarithmic scale to facilitate the representation of quantities of incomparable magnitude.

Certain special regimes like reduced rates or different rates for sparkling products are not displayed to help readability.

Plato degrees have been converted into ABV using a conventional factor of 2.4.

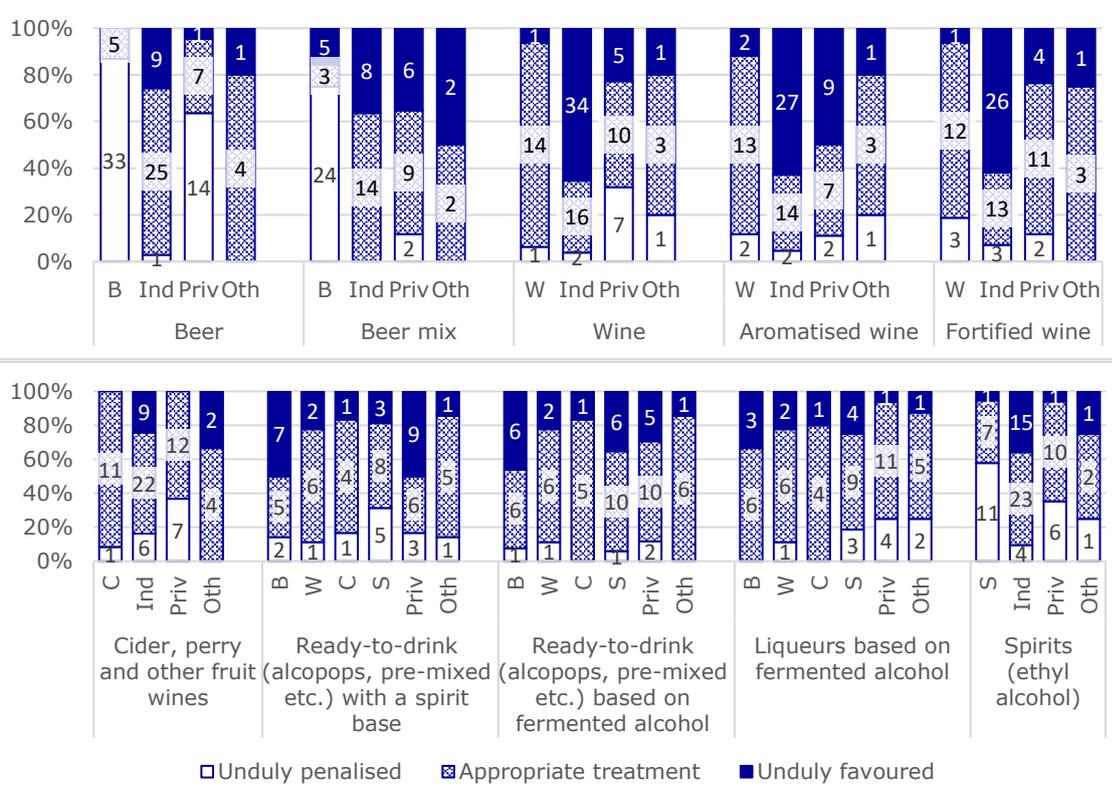
The shaded rectangles highlight certain 'critical' ABV thresholds relevant for this Study, i.e. 5.5%, 10%, 15% and 22%.

**Legend:** B: beer; W: wine; OFB: other fermented beverages; cid: cider; IP: intermediate products; ET: ethyl alcohol; ET Reg: reduced rate for ethyl alcohol from particular regions; PM2206: fermented-base pre-mix; PM2208: spirit-base pre-mix; st: still; sp: sparkling.

**Box 8 – Results from the OPC: perceived tax advantages between different categories of alcoholic beverage**

Ciders and 'difficult-to-classify' products, such as RTDs (both spirit- and fermented-based) and liqueurs based on fermented alcohol, are generally considered to be appropriately taxed. To the contrary, beer producers and private individuals believe beer is unduly penalised, especially when compared to wine (and other wine products, such as AWP and fortified wines), which is considered by the non-wine industry to be unduly favoured. Similarly, spirits producers are of the opinion that their products are currently unduly penalised.

**Question #18** - The current tax classification system may potentially create competitive advantages or disadvantages for different classes of products. In your opinion, which classes are unduly penalised or favoured by the current tax regime?



**Source:** OPC.

**Legend:** B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Ind: rest of the industry (not included in the previous category); Priv: private individuals; Oth: Other (public health NGOs, public authorities, etc.).

**Note:** industry stakeholders with an interest in the production or end-use of industrial alcohol have been included in the 'Ind' category whenever present. If not present, they have been included in the residual 'Oth' category.

Producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

➤ **THE SCALE AND TREND OF ADVERSE EFFECTS**

The possible adverse effects identified in the 'problem tree' (Figure 1 1) and the expected trends are analysed and – where feasible – quantified in this Section. To sum up, these include: (i) legal uncertainty and disputes; (ii) administrative burden caused

by classification issues; (iii) tax-induced competition issues; (iv) foregone tax revenues; and (v) possible negative effects on alcohol control policy and public health.

- **Legal uncertainty and disputes**

The level and severity of the legal uncertainty that may derive from the above classification issues is connected primarily to the specificities of national markets, and the classification rules adopted. Most of the CJEU landmark cases originated in the Netherlands, which according to various commentators are a major hub for the production and distribution of alcoholic beverages of industrial origin, including of innovative kind. It is therefore not surprising that the Netherlands anticipated other MS in the legal debate on the treatment of certain 'borderline' products and that in this country the disputes with economic operators have been more frequent than elsewhere. The peak period of cases was mostly prior to the CJEU C-150/08 ruling, during which some 15-20 disputes reportedly took place. After the CJEU ruling, the number of cases decreased and the focus of classification disputes gradually switched from the proportion of alcohol that can be added to a fermented beverage to broader criteria to measure the essential fermented character of a drink. In the other MS examined, the number of legal classification cases was seemingly much smaller: some authority reported just 1-2 cases, while others none.

Of course, court cases do not capture all instances of disagreement and disputes over the classification of products that took place in the various MS. In fact, especially where the matter is in the remit of customs offices instead of tax offices, the disputes are reportedly settled through alternative methods: when a misclassification is detected, the competent administration imposes the payment of a certain amount of tax arrears (with/without a fine) to the responsible entity. Economic operators prefer this procedure rather than opening a legal case, since it is faster, it often envisages the possibility of negotiations, and it does not imply public disclosure, so the potential reputational effects are minimised. However, for this very reason precise figures on the frequency of administrative cases are not available.

In any case, legal or administrative disputes are only an imperfect indicator of the legal uncertainty for the simple reason that a dispute does not necessarily imply a 'difficult-to-classify' dossier, but rather a divergence of views between customs authorities and economic operators. In other words, there can be disputes around products for which the classification is straightforward in customs authorities' views, and there can be 'difficult dossiers' that do not end up in disputes because the dossiers are submitted only for a preliminary opinion. Actually, it can be argued that - after CJEU rulings - and the high costs borne by certain economic operators<sup>124</sup>, there remained limited appetite for litigation, and economic operators including both brand owners and wholesalers and distributors have become more risk-wary towards the placement on the market of new products if not clearly identified.

The primary mechanism to prevent disputes is the issuance of BTI decisions for borderline products. As shown previously (see Table 7), of the nearly 1,000 active BTIs for alcoholic beverages, some half of them concern products falling in the residual sub-heading of CN 2206 and CN 2208, clearly highlighting that the recourse to BTIs was mainly driven by the need to have a stable and predictable treatment for the type of 'borderline' products analysed here. Reportedly, there have been also cases in the past of 'BTI shopping', i.e. requests for BTIs submitted in MS where a favourable classification was considered more probable. Of course, the BTI decision could not be precisely

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<sup>124</sup> Various companies have seen their turnover halved as a consequence of the re-classification of part of their portfolio under CN 2208, and there were cases of enterprises who nearly went bankrupt due to the high tax arrears.

anticipated and there have been certainly cases where the result was not in line with applicants' expectations. For a 'borderline' product, being classified as CN 2206 or CN 2208 is often a matter of commercial viability or not, and very likely the products that did not obtain the desired classification were withdrawn.<sup>125</sup> Moreover, the BTI rules and practices have seemingly changed overtime: BTI shopping has become less feasible, and some customs release BTI decisions only to products for export. Finally, BTIs are not exempt from disputes, although concrete cases are rare, and national authorities rarely challenge a BTI issued by another MS.

More generally, the risk of pervasive adverse effects on international trade due to classification disputes is taken in serious consideration so, according to some stakeholders, other countries' classifications of beverages, including from third countries, are seldom the subject of legal challenges that might trigger broader trade issues.

The cost of litigations could be significant also for public administrations, and for this reason certain countries encourage the recourse to preventive non-binding classification opinions. In France a specific platform, i.e. *Soprano*<sup>126</sup>, has been established to this end. The platform allowed authorised operators to submit classification dossiers to obtain a preliminary opinion in a faster way. The platform was launched in 2017 and is currently for voluntary use, but if successful it might become the standard procedure for the submission of applications. In addition to preventing disputes, the expected benefits of *Soprano* include also a reduced length of procedures, so a shorter 'time-to-market' for enterprises.

With respect to future trends, it can be observed that there are no signs or sentiment among stakeholders of a possible recrudescence of legal disputes. Conversely, more and more countries have invested in updating their classification procedures and systems with the result that the number of 'difficult to classify' cases is now more modest than before. The nature of 'borderline' products is different across markets since it relates to specific consumer preferences and opportunities, but in general the problematic area seems to increasingly focus on fermented bases having undergone some form of concentration and/or cleaning, both traded as such or used in final beverages. Cases were reported of products stored in the producers' tax warehouses as CN 2208, then dispatched to another country as CN 2206; beverages moved to a bordering country, re-bottled and moved back with a more favourable classification; trade of entirely fermented bases with ABV of 22% coded as CN 2206 etc. In this respect, the type of products that originated the CJEU case ten years ago are no longer the core of classification issue, and other new challenges are seemingly emerging.

- **Administrative burden caused by classification issues**

Besides the risk and the costs of disputes, the lack of clear criteria and parameters for the classification of certain 'borderline' products makes the process more complex, long, and unpredictable, for both economic operators and administrations. Although the process concerns formally the customs classification, it is the consequent excise duty categorisation that is primarily at stake, so the administrative burden caused by uncertainties in the CN classification should be considered as directly related to the functioning of the excise duty system.

For economic operators who develop and commercialise 'borderline' products the administrative burden related to a difficult classification process is likely factored-in, since it can be assumed that their aim is precisely to exploit classification ambiguities. Of

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<sup>125</sup> This possibly explains the fact that the internal analysis of the EBTI database carried out by DG TAXUD in support to this Study reportedly returned very limited matches with products currently on the market, according to the IWSR intelligence.

<sup>126</sup> <https://pro.douane.gouv.fr/prodouane.asp>

course, not all the 'difficult-to-classify' products are developed for tax optimisation purposes, and some of them are simply innovative products. But also in this case, there seems to be no particular extra burden besides the ordinary requirements (submission of a dossier and sample etc.) applicable to any innovative products to be launched on the market.

The bulk of the extra burden is borne by competent authorities. This relates primarily to the additional efforts required to deal with complex classification cases, including laboratory tests and the extra labour to manage the dossier and liaise with the applicant. The level of effort evidently depends on the number of 'problematic' cases to handle, which in turns relate to the size and specificities of national markets and on the availability of a robust classification criteria and analytical methodologies. To cope with the mounting number of 'borderline' products various MS (e.g. DE, NL, FR) have set up *ad hoc* expert groups or panels in charge of defining detailed classification rules and procedures and to ensure consistency in their tax treatment. Typically, these groups operate at the central level, collating the difficult cases that cannot be solved by regional customs offices. It has also been reported an intensification of the collaboration and exchanges between customs authorities at EU and international level aimed at resolving the uncertainties in the interpretation and operationalisation of the subjective criteria concerning certain CN 2206 products.

The customs administrations interviewed were generally not in the position to estimate the frequency of problematic products cases, and the administrative burden attributable to these dossiers, so only tentative estimates can be provided. In Table 22 below, we have elaborated a three scenarios for both the number of new classification dossiers undergoing laboratory analysis in a year (not including routine and periodical updates) and the average cost per dossier (staff/hours to evade it). The estimates are based on a few benchmarks collected during the fieldwork in the sample MS, and on average hourly tariffs derived from Eurostat. The central value between the upper and the lower limits falls in the region of EUR 1.0 – 1.5 mn per year at EU-level. The scenarios are highly speculative, so they have to be taken with caution and only as a possible measure of the scale of the problem.

**Table 22 – Hypothetical scenarios for estimating the administrative burden of classifying borderline products**

Scenarios	Number of classification dossier undergoing laboratory analysis (EU28 / year)	Number of hours / unit costs per dossier (laboratories + central administrations, where needed) Hourly tariff: EUR 23.2*		
		Low (5h)	Middle (10h)	High (15h)
Low	2,000	€0.23 mn	€0.46 mn	€0.70 mn
Middle	5,000	€0.58 mn	€1.16 mn	€1.74 mn
High	8,000	€0.93 mn	€1.86 mn	€2.78 mn

**Source:** Author's estimates based on benchmarks collected from interviews, and Eurostat data on Hourly Earnings in the EU.

**Note:** (\*) Average tariff for ISCO 3 category 'Technicians and associate professionals', inclusive of Hourly Earnings adjusted + Non-wage Labour Costs + 25% Overhead.

- **Tax-induced competition issues**

In Section 2.1.4.2 above, we have estimated the market volume of the product categories that may contain the 'borderline' products, as defined in this Study. The underlying assumption is that unintended tax-induced substitution and the ensuing competition issues may happen, if any, within these categories. However, it is not feasible to determine precisely what share of these products have been developed purely for tax optimisation purposes, or what is the importance of an advantageous tax classification *vis-à-vis* other factors. For analytical purposes we have therefore treated all products falling into these categories as if they were 'intended' borderline products, liable to be addressed by a normative revision placing them in a more appropriate tax

category. This is evidently a speculative scenario whose primary merit is to allow an estimation of the order of magnitude of the phenomenon with respect to the ordinary alcoholic beverages.

The Study findings suggest that the dimension of the categories containing 'borderline' products are limited in volume terms (see Table 23). The mixed drink category amounts to an estimated 78 mn litres that is approximately 6% of the 'fiscal' OFB category. According to the broad definition used in this Study, 'borderline' cider may amount to another 11% of fiscal OFB category (up to 32% if the UK market is considered). Overall, the 'borderline' products of OFB type represent about 0.44% of the total EU market of alcoholic beverages (nearly 1% if the UK cider is included).

Another excise duty category potentially containing 'borderline' products is IP. As seen, there are medium/high strength beverages and mixed drinks with a fermented base that are similar in various respects to equivalent spirit-based liqueurs (e.g. certain licorettes, cream liqueurs, RTD cocktails etc.), but are possibly taxed in accordance with Article 17 instead of Article 20. In our estimation, this category amounts to some 75 mn litres. Also in this case the overall dimension of market at stake is moderate but not negligible, i.e. some 24% of the total IP. At general level, the size of this category of products is modest, accounting for only 0.14% of the total market of alcoholic beverages.

**Table 23 – Estimated market volume of 'borderline' products, and as a share of relevant excise duty categories and the overall EU market (2016)**

'Borderline' products	Fiscal category affected	Quantity mn litres	OFB	IP	All
			<b>1,358.25</b>	<b>312.22</b>	<b>52,399.50</b>
'Borderline' OFB: low-strength mixed drinks with a fermented base)	<b>OFB (Art. 12)</b>	<b>78.4</b>	5,77%	..	0,15%
'Borderline' cider	<b>OFB (Art. 12)</b>	<b>152.0</b> (435.3)*	11,19% (32.05%)*	..	0,29% (0.83%)*
'Borderline' IP: medium/high strength beverages with a fermented base (including mixed drinks)	<b>IP (Art. 17)</b>	<b>75.5</b>	..	24,20%	0,14%
<b>Total</b>		<b>305.9</b> (589.2)*	<b>16.97%</b> (37.83%)*	<b>24.20%</b>	<b>0.58%</b> (1.12%)*

**Source:** Author's estimates based on IWSR data and own market analysis.

**Notes:** As regards medium-strength mixed drinks with a (supposed) entire fermented base only one product has been found, so they have not been included in the quantitative assessment. Medium-strength mixed drinks with a mixed base are often treated as ethyl alcohol. When not (only an estimated 2.5 mn litres), they have been added to the category of 'borderline' IP. High-strength mixed drink with a fermented base (and treated accordingly) are virtually non-existent so are not included in the analysis

The estimates for 'borderline' cider marked with (\*) include also the UK cider market. The cells marked with (..) indicate the ratio is not relevant, since the 'borderline' products considered may not affect the corresponding fiscal category.

In theoretical terms, the above figures represent also the 'upper limit' of the tax-induced substitution potential of 'borderline' products, vis-à-vis the other tax categories. The comparison is obviously relevant with more heavily taxed categories, i.e.: (i) OFB versus IP, and (ii) OFB and IP versus ET. In the first case, it can be noted that low-strength mixed drinks represent one-fourth of the overall IP category, so under certain circumstances (actual tax rate differential) and for certain categories of products (i.e. not considering special products like PDO/PGI fortified wines) it can be assumed that mixed drinks may indeed constitute a competitive threat to other IP products. This potential is magnified if 'borderline' cider is considered, with the UK market alone nearly as big as the entire EU market of IP.

The comparison with spirits is not straightforward, since these products' average strength is typically 5-8 times higher. Taking into account the respective strengths, the

potential of mixed drink to induce substitution from spirits is negligible. Of course, in a micro perspective, mixed drinks with a fermented base may (and did) represent a cheaper alternative to spirit-based mixed drinks, thanks to the more favourable tax treatment, thus posing a potential competition issue. It is precisely in this respect that the scenario for a different tax treatment of mixed drinks have been developed in this Study. Since 'borderline' cider does generally not contain added alcohol the possible tax-induced substitution with spirits (including spirits-based mixed drinks) seems of limited relevance. It is instead very relevant the substitution potential of 'borderline' IP with spirits, especially in specific segments like liqueurs and other flavoured spirits. In aggregated terms, the size of the impact appears limited, since 'borderline' IP represent only 3.3% of the Ethyl Alcohol category (and not considering the differences in the average strength), on the other hand, substantial distortions of competition seem possible for specific product lines and in certain geographical markets.

- **Foregone tax revenues**

The hypothetical tax-induced substitution described above may influence the amount of excise duty that is collected. Since we have defined 'borderline' products as products primarily conceived to take advantage of classification uncertainties to have access to favourable tax treatment, the impact on tax revenues stems directly from their *raison d'être*. The above figures on their market dimension can be used to estimate the scale of foregone revenues possibly attributable to 'borderline' products. As for market dimensions, these estimates should be considered the upper boundary, since not all the products falling in the categories at stake are there (only) to exploit a more favourable regime.

The exercise is highly speculative but may provide useful indication on the magnitude of the problems in absolute and relative terms. First of all, the type of tax advantage potentially sought is different. As discussed above:

- 'Borderline' OFB (low-strength mixed drinks) may seek a competitive tax advantage against mixed drinks with a spirit base (taxed as ethyl alcohol), or against Intermediate Products;
- The 'borderline' IP (medium/high strength beverages) considered here are arguably taxed as IP but compete with spirit liqueurs and other drinks of similar or higher strength that are taxed as Ethyl Alcohol;
- 'borderline' cider is a special case, since it may primarily distort its own tax category (OFB), competing with other 'traditional' cider and OFB. According to some views, 'borderline' cider is less expensive to produce than 'traditional' cider; secondly, it is often sweetened and/or flavoured and therefore similar, from consumer's perspective, to certain pre-mixes and RTDs. Since they do not commonly contain ethyl alcohol it is more appropriate in this simulation to compare them with IP and not with Ethyl Alcohol - as it is the case for instance in RO, and to some extent in the UK, for non-cider OFB.

As shown in Table 24 below, if taxed at the current average excise duty rates, 'borderline' products would pay an overall excise of approximately EUR 311 mn (EUR 589 mn including British cider). If low-strength mixed drinks and 'borderline' cider were taxed as IP at the current average rate, the virtual revenue (EU-wide) would increase by some EUR 267 mn (EUR 596 mn including British cider), while if 'borderline' OFB and IP were taxed as ethyl alcohol (taking into account the different alcoholic strength) the revenue increase would be of EUR 585 mn. These estimates are purely theoretical since as shown in details in Section 3.1.2.2, an actual increase in the tax rate would affect the level of consumption and therefore of tax revenue. In this sense, it is useful to consider also a radically different scenario: if the 'borderline' products were replaced by standard products, in the current proportion and taxed at the current average rate, there would be a net excise duty loss of nearly EUR 102 mn (EUR 116 mn including British cider).

**Table 24 - Estimated tax revenue from 'borderline' products under hypothetical substitution scenarios**

Problematic products	Volume (mn L)	Average ED rate – EU28 (€/L)	Baseline ED revenue (€ mn)	Virtual ED revenue as IP (€ mn)	Virtual ED as adjusted ET (€ mn)	Virtual revenue if substituted in line with market distribution (€ mn)
'Borderline' OFB: low-strength mixed drinks with a fermented base)	78.4	0.73 (OFB)	57.2	148.2	211.7	53.4
'Borderline' cider	152.0 (435.3)*	0.73 (OFB)	111.0 (317.8)*	287.3 (822.7)*	111.0 (317.8)*	103.6 (296.6)*
'Borderline' IP: medium/high strength beverages with a fermented base (including mixed drinks)	75.5	1.89 (IP)	142.7	142.7	573.8	51.4
<b>Total</b>	<b>305.9 (589.2)*</b>		<b>310.9 (517.7)*</b>	<b>578.2 (1,113.6)*</b>	<b>896.4 (1,103.2)*</b>	<b>208.4 (401.5)*</b>
				<b>+267.2 (+595.9)*</b>	<b>+585.5</b>	<b>-102.4 (-116.2)*</b>
<b>Difference w/ baseline</b>						

**Source:** Author's elaboration based on IWSR data and EDT and own simulations.

**Notes:** the average excise duty (ED) rate refers to the simple EU28 average, therefore the 'baseline' ED revenue is not the 'actual' revenue but the hypothetical ED revenues obtained multiplying the quantity of product to the average ED rate applicable. This approach allows to neutralise MS-level specificities in the estimates.

The 'adjusted' ET scenario takes into account the strength of equivalent beverages. For 'borderline' OFB, it is equal to €2.7 / litre and is calculated as the average duty actually levied on spirit-based mixed drink in the 6 sample MS. For 'borderline' IP it is equal to €7.6 / litre and is calculated as the average duty actually levied on all spirit drinks (except mixed drink) in the 6 sample MS.

The last column correspond to the scenario where the entire volume of borderline products was taxed as a standard basket of products, i.e. taking into account the relative distribution that exist today across categories (i.e. beer represents 60%, wine 33% etc.).

(\*) including the UK cider market.

#### • **Estimated effects on alcohol control policies and public health**

In line with the above considerations on the relationship between tax, affordability and consumption at systemic level, we consider of modest magnitude the overall negative impact on per capita consumption of alcohol possibly caused by the tax-induced substitution between 'standard' and 'borderline' products. This does not evidently deny the existence of problems linked to the consumption of certain alcoholic beverages by certain socioeconomic segments of the population, which have been tackled *inter alia* through *ad hoc* national taxes. However, the evidence collected in countries that adopted *ad hoc* fiscal measures to tackle emerging problems like 'alcopops' suggest that alcohol consumption did not reduce but shifted to other products. In this sense, other additional measures restraining physical accessibility and availability, restricting marketing/advertising etc. seem necessary to achieve a general reduction of per capita consumption of alcohol.

This was reflected upon by various public health stakeholders interviewed. On fiscal policies, their position is generally in favour of a major review of excise structure toward a taxation per ABV for all product (not in the scope of the current Study). Outside of it, minor adjustments are not seen as having a significant impact since consumers and the market would always find a new equilibrium. This was the case, again, with the alcopop tax in Germany that, according to a few studies (summarised in Box 9), did not eventually affected total consumption but only preferences.

Finally, we have compared the trends in per capita consumption of alcohol registered by WHO – GISAH with the trends in the excise duty rate growth, but no clear pattern could be identified. Actually, the results show that the strongest decline in alcohol consumption concerns spirits (-2.11% in seven years), which is however the category where excise duty increase was the lowest (+ 2.4, see Table 19), further confirming that the link between excise duty levels and per capita consumption is not straightforward.

**Box 9 – Excerpts from the literature review on the impact of alcopop tax on youth drinking**

*Muller S, Piontek D, Pabst A, Baumeister SE, Kraus L, Changes in alcohol consumption and beverage preference among adolescents after the introduction of the alcopops tax in Germany. Addiction 2010; 105:1205-13.*

This study aimed at assessing the contribution of the alcopops tax introduced in Germany in July 2004 to changes in alcohol consumption and beverage preference among adolescents. The analysis was based on 2003 and 2007 data from the cross-sectional survey of the European School Survey Project on Alcohol and other Drugs (ESPAD). The impact of the new tax on the retail prices, which nearly doubled, and the ensuing reduction in the consumption of alcopops (from 28.4% in 2004 to 15.6% in 2005 among 12–17-year-olds) was evident. However, the study found that, between 2003 and 2007, adolescents' beverage preferences changed. The proportion of students preferring alcopops decreased from 27.3% to 12.4%, whereas the proportion of students favouring beer and spirits increased by 5.8% and 7.8%, respectively. During the same period, no significant changes in the total alcohol volume consumption (the volume of spirits increased by 8 g of ethanol, while the volume of alcopops decreased by 9 g). As a result, the study concluded that 'effective alcohol policies to prevent alcohol-related problems should focus upon the reduction of total alcohol consumption instead of regulating singular beverages'.

*Anderson P, Suhrcke M and Brookes C (2012), An overview of the market for alcohol beverages of potentially particular appeal to minors. London: HAPI.*

According to this study, the introduction of the alcopop tax in Germany was largely ineffective in reducing the consumption of ready-to-drink (RTD) beverages. Between 2005 and 2010, the total volume of spirit-based RTD fell by 74.2% and the tax revenue generated by this kind of alcoholic beverage collapsed from EUR 9.6 million to 2.4 million (-75%). However, the analysis of annual spending per capita on RTD and high-strength (HS) pre-mixes suggests substantially different developments. After the initial decline, the per capita annual spending on RTD/HS has been constantly on rise in the following years, reaching some EUR 39 in 2008, nearly the same amount Germans were spending before the introduction of the tax (EUR 40), and remaining well above the EU average. This result is essentially explained by the countermoves taken by the alcohol industry players, which introduced new RTDs and high-strength pre-mixes, such as malt-based RTDs, that are exempt from the alcopop tax.

➤ **THE STAKEHOLDERS' PERCEIVED ISSUES WITH BORDERLINE PRODUCTS**

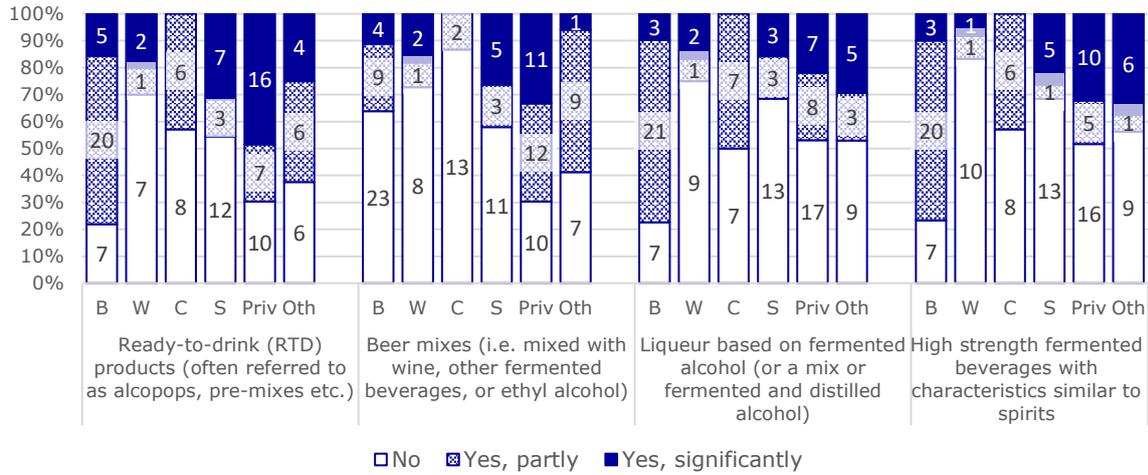
In conclusion, it is useful to complement the above analysis with the qualitative feedbacks collected through the OPC on the existence of market distortions determined by the more favourable tax treatment enjoyed by certain products, and the extent and frequency of 'difficult to classify' products.

The distribution of responses and a summary of the key analytical findings are provided in Box 10 below.

**Box 10 – Results from the OPC: perceived need to reconsider the tax treatment of certain products**

All industry stakeholders tend to agree that there is no need to reconsider the tax treatment of RTDs, beer-mixes, fermented-base liqueurs and high strength fermented beverages, with the only exception of beer producers who – while they see no issue with beer-mixes – consider that the treatment of the other products may require a partial revision. To the contrary, the majority of private individuals and of respondents falling into the residual 'other' category believe the tax treatment of the products, and especially RTDs, needs to be reconsidered. In addition to the four products envisaged in the questionnaire, respondents flagged aromatised wine-based drinks, sometimes referred to as 'new generation vermouths', as products requiring greater clarity in terms of classification and taxation.

**Question #13** - The current classification rules may create situations where certain new beverages may be placed on the market at a relatively affordable price, due to a favourable tax treatment. In your opinion is there a general need to reconsider the tax treatment of the following types of products?



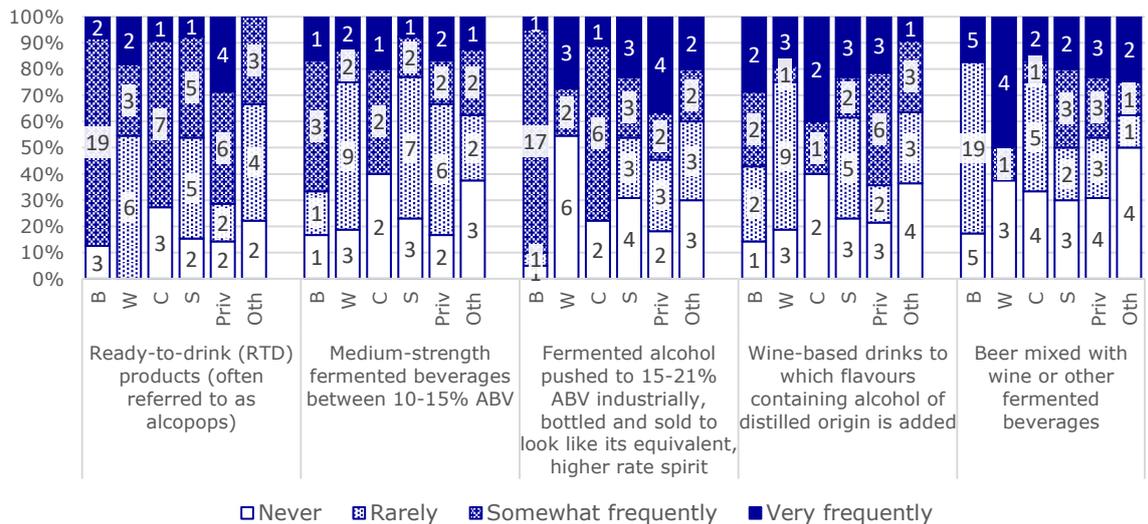
Source: OPC.

Legend: B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

Note: producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

Beer and cider producers, which in many cases coincide since producers are involved in multiple markets, consider the classification of beer-mixes as largely straightforward, while to the contrary the classification of all the other 'difficult-to-classify' products allegedly creates somewhat frequent issues and disputes. Conversely, the majority of wine and spirits producers tend to experience issues of classification only rarely, if not at all.

**Question #17** - The evaluation of the Directive carried out in 2015/16 identified several 'difficult-to-classify' product groups, which are listed below. In your experience, how often do classification uncertainties and disputes occur with the following classes of products?



Source: OPC.

Legend: B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

Note: producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

### **2.1.5.2 Unclear application of the 'entirely fermented origins' provision to beverages containing alcohol as a flavour-carrier.**

The Ramboll Evaluation reported the existence of different interpretations across MS of the meaning of the criterion 'entirely of fermented origin' that concurs to the definition of wine and OFB comprised between 10% vol (13% vol for sparkling products) laid down in Article 8 and Article 12 of the Directive. As discussed above, the issue at stake is the addition of alcohol-based aromas and whether and how it may be a cause of loss of the status of 'entirely fermented origin'. The lack of a harmonised approach might lead to situations where the same beverage is classified as a wine or OFB in some MS and as a more-heavily taxed Intermediate Product in other MS, with potential adverse impacts on internal market functioning and tax revenues.

In principle, the issue may apply also to certain flavoured beers. Article 2 of the Directive does not contain the above provision, and different national approaches were registered towards the addition of minimal amounts of alcohol to beer. Importantly, the addition of alcohol for flavouring purposes to beer has been allowed by Regulation 1967/2005, so it can be assumed that, if the maximum threshold indicated in the Regulation is respected, flavoured beer should not pose classification issues.

Actually, field interviews with stakeholders in the six sample MS indicate that also in the case of wine and OFB the issue is of modest relevance. This is further confirmed by OPC results, with only one-fourth of wine producers admitting possible issues with products containing alcohol-based aromas. The perceived limited importance of this issue seemingly relate to the following factors:

- The existence of legislation indicating that the addition of alcohol as a flavour-carrier (AFC) should not be considered as a fortification, if used in modest amount and not exceeding the strictly necessary dose. This is clearly stated in the Regulation 251/2014 on aromatised wine products, and can be inferred from Regulation 1967/2005 in the case of beer. National authorities seem generally inclined to uptake this principle when dealing with those products.
- Some MS have adopted domestic rules that *de iure* or *de facto* exempt the alcohol added as a flavour-carrier in the categorisation of fermented beverages, when the amount added is below a specific threshold. In our sample, all MS except Romania have reportedly set a maximum threshold varying between 0.5% of the total ABV (e.g. Finland) to 1.2% ABV (e.g. Italy), with possibly different thresholds for products of different type.<sup>127</sup> Thresholds were seemingly set with reference to the limit below which a beverage is not considered alcoholic.
- Detecting very small quantities of distilled alcohol in a fermented beverage through laboratory analysis is difficult and burdensome, so a certain degree of tolerance is considered a cost-efficient approach, also taking into account that the market of flavoured beverages is small.

Nonetheless, the notion 'entirely fermented origin' laid down in the text of the Directive lends itself to a restrictive interpretation and in the absence of a clear regulatory status for AFC the corresponding products may be subject to classification disparities. In particular:

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<sup>127</sup> Some countries reportedly apply the threshold only to wine and OFB, since for beer Article 2 of the Directive is not explicit.

- **Aromatised wine products:** under a restrictive interpretation of Article 8 aromatised wine-product cocktails with an ABV of 7-10%, aromatised wine-based drinks with an ABV of 7-14.5%, and aromatised wine between 14.5% and 15% (18% if without enrichment) might be considered fortified and categorised as Intermediate Products instead of Wine.<sup>128</sup>
- **Flavoured OFB:** the addition of alcohol is permitted up to 10%<sup>129</sup> vol. so the issue – if any – may regard only products in the 10%-15% range, which could be categorised as Intermediate Products instead of OFB. Based on our sample of products from six MS, this category seems however marginal and not relevant for a quantitative analysis.<sup>130</sup>

Based on the market estimates calculated previously (baseline assessment), Table 25 below provides an approximate estimate of the excise duty amount that is at stake when applying either of the two possible approaches to AFC-containing aromatised wine products. Assuming, in line with our sample, that one-sixth of MS applies a strict interpretation, this may translate into some 13-38 mn litres of alcoholic beverages taxed as Intermediate Product and generating a figurative revenue between EUR 24 mn and EUR 71 mn. Instead, the amount of products categorised as wine may fall in the 63 – 188 mn litres range for an overall excise yield of EUR 50 – 152 mn.

The above scenarios do not take into account, due to the lack of precise data, the actual distribution of products across MS, which is high in countries with a low or zero tax rate for wine such as France. In this sense, the actual excise yield from AFC-containing AWP is probably closer to the low end (EUR 50 mn) rather than to the high scenario. The scenario on the tax revenue stemming from a strict interpretation assumes that all AFC-containing products in a given national market pay the excise duty of Intermediate Product. This is evidently a hypothetical scenario, since if taxed as IP the competitiveness of many of these products would be seriously hampered and their market would likely shrink.

With respect to future trends, two considerations apply: (i) an increasing number of MS have adopted a flexible approach to AFC, possibly in connection with the EU-level legislation mentioned above. This trend is likely to continue, since also MS that have not set explicit threshold for AFC are reportedly inclined to maintain margins of tolerance in the classification of these products. So disparities of treatment are progressively less likely; (ii) on the other hand, the market size of these products is growing, although moderately, so the risk of abuses may become more relevant in the future.

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<sup>128</sup> This possibility seems very unlikely since Reg. 251/2014 states: '*the ethyl alcohol used to dilute or dissolve colorants, flavourings or any other authorised additives used in the preparation of aromatised wine products must be of agricultural origin and must be used in the dose strictly necessary and is not considered as addition of alcohol for the purpose of production of an aromatised wine product*'. However, the last line makes reference to production purposes, so not necessarily 'tax purposes'.

<sup>129</sup> Unless Article 17(2) is triggered, in which case still OFB in the 5.5%-15% range and sparkling OFB in the 8.5%-15% could be affected'

<sup>130</sup> Both traditional and 'mass-market' ciders seldom exceed 10% vol. Also, mixed drinks with a fermented base are typically below 10%.

**Table 25 – Estimated amount of AFC-containing aromatised wine products and excise duty value at stake**

	Volume of products containing AFC (mn litres)	Est. volume in MS adopting a strict interpretation (mn litres)	Figurative excise duty in MS adopting a strict interpretation (in € mn)	Est. volume in MS adopting a margin of tolerance (mn litres)	Figurative excise duty in MS adopting a margin of tolerance (in € mn)
<b>Aromatised wine products</b>	Low (25%): 75.4 Medium (50%): 150.7 High (75%): 226.1	L: 12.6 M: 25.1 H: 37.7	L: €23.7 M: €47.4 H: €71.1	L: 62.8 M: 125.6 H: 188.4	L: €50.6 M: €101.28 H: €151.9

**Source:** Author's elaboration based on IWSR and EDT raw data.

**Note:** The simulation assumes that in 1/6<sup>th</sup> of EU MS a strict interpretation of the 'entirely fermented origin' provision applies. The figurative excise duty yield is calculated using the average excise duty in the EU for intermediate products (strict interpretation) and wine (margin of tolerance).

The issue of AFC does not cause relevant adverse effects of other nature. As discussed, the matter is reported as not problematic by authorities and operators alike and no present or past dispute was reported (beside cases concerning products that might have exceeded the AFC tolerance threshold). The adoption of a tolerance threshold certainly reduces the need for investigating this category of products with possible enforcement cost savings (unfeasible to quantify). As the amount of alcohol added is minimal, and the products at stake are a niche of the alcoholic beverages market, also the impact on the per capita consumption of alcohol are of no relevance for this IA Study.

### 2.1.5.3 Indefinite excise product code for Wine and OFB

The Excise Product Codes (EPC) applicable to product categories defined in the Directive are laid down in Annex II of Commission Regulation No 684/2009.<sup>131</sup> Currently, 'still wine' and 'still fermented beverages' share the same EPC, i.e. W200, and the same happens with 'sparkling wine' and 'sparkling fermented beverages', both of which fall under W300. The Ramboll Evaluation noted that this arrangement is not ideal for MS that have a differential tax treatment, and concluded: '*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*'.<sup>132</sup> The problem, if any, regards 'borderline' products (mixed products) for which the risk of misclassification is plausible, e.g. between wine-based and other fruit-based aromatised products and mixed drinks. The consequences of misclassification would be an incorrect calculation of the excise duty that has to be paid, as well as of the financial guarantee required.

At the same time, the Ramboll Evaluation recognised that the issue is currently not causing any major adverse effects: '*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*'.<sup>133</sup>

For the baseline assessment it is therefore relevant in the first place to review which countries have a differential treatment of wine and OFB and what volume of products is at stake (Table 26). Overall, there are six MS applying a different tax rate to Wine and OFB (still and/or sparkling). Actually, in three cases the different rates concern

<sup>131</sup> 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 goods under suspension of excise duty, OJ L 197, 29.7.2009.

<sup>132</sup> Ramboll Evaluation (2016), p. 133.

<sup>133</sup> Ibid.

only a sub-class of OFB products i.e. cider and perry (defined in national terms). In the case of France, the difference concerns only sparkling beverages. The total amount of OFB that is taxed *ad hoc* is estimated at 169 mn litres, which correspond to an overall excise duty value of EUR 237 mn, the bulk of it (98%) relates to Ireland. Overall, the data shows the marginality of the issue: when compared to the total OFB and the total Wine + OFB markets, the products with an *ad hoc* tax treatment account to approximately 13% and 1% respectively.

Moreover, it should be noted that the only cases where an OFB product might have an incentive in being 'misclassified' as Wine are Hungary and Romania, since in all other countries Wine is taxed more heavily. In other words, the overall risk of tax losses due to the absence of a separate EPC (and EMCS) coding regard a tiny 0.6% (some 8 mn litres) of the overall OFB. The quantitative analysis is confirmed by the feedback collected through interviews, with the majority of stakeholders (exception made for a few Romanian interviewees) reporting no relevant difficulty with the current aggregate EPC codes.

The differential tax treatment between cider and generic OFB may also require a separate coding for better monitoring and control, but this distinction is not currently supported by the Directive. In the event of a revised OFB category, with possible distinction between sub-classes of products, the overall picture would be different and the need for a separate EPC would become important. This is discussed in greater detail in Section 3.1.

**Table 26 – Overview of MS with a different tax treatment for Wine and OFB products**

MS	Excise duty rate on wine (€/hl)	Excise duty rate on OFB (€/hl)	Volume of OFB products concerned (mn litres)*	Excise duty revenue at stake (€ mn)
FR	9.33 sparkling	3.77 sparkling	8.2 (sparkling)	0.3
HU	0.00	31.55	5.6 (still) 0.6 (sparkling)	1.8
IE	424.84 (still. <=15% vol) 849.68 (sparkling)	309.84 (cider and perry. still) 619.70 (cider and perry. sparkling)	61.3 (still) 6.8 (sparkling)	232.1
MT	205.00 (still & sparkling)	20.00 (still & sparkling)	0.3 (still) <0.1 (sparkling)	0.1
PL	37.21	22.85 (cider and perry)	9.4 (still) 1.5 (sparkling)	2.4
RO	0.00 (still and sparkling)	89.87 (generic OFB. still) 10.73 (generic OFB. sparkling)	<0.1 (still) 2.0 (sparkling)	0.2
		<b>TOTAL</b>	<b>168.6</b>	<b>236.8</b>

**Source:** Author's elaboration based on IWSR and EDT raw data.

**Notes:** the quantities displayed relate to the share of OFB that is taxed differently than the corresponding wine category and for which misclassification would therefore have an impact.

(\*) The precise share of sparkling cider on the total was not available, so a qualitative conventional 10% has been applied.

In the case of Romania, still OFB is practically non-existent, since nearly all cider (traditional and mass-market) has reportedly access to the zero tax applied also to wine.

Countries where differences regard reduced rate provisions (such as the UK) are not displayed.

## ➤ SUMMARY OF PROBLEM ANALYSIS

Specific problem areas	Adverse Effects	Expected evolution
<b>Uncertain scope of the category 'Other Fermented Beverage'</b>	<ul style="list-style-type: none"> <li>Administrative burden for products difficult to classify.</li> <li>Risk of legal disputes.</li> <li>Tax-induced substitution and competition issues.</li> <li>Tax revenue losses.</li> </ul>	<ul style="list-style-type: none"> <li>The market for OFB is stable or declining for mixed drinks, slightly growing for 'borderline' cider.</li> <li>Classification uncertainties and disputes are less frequent over the years. But the disparities across MS are going to persist.</li> </ul>

Specific problem areas	Adverse Effects	Expected evolution
<p><b>Unclear application of the 'entirely fermented origin' provision to beverages containing alcohol as a flavour-carrier</b></p>	<ul style="list-style-type: none"> <li>• Uncertain and diverging interpretation may cause market distortions.</li> <li>• Related tax revenue effects are possible.</li> </ul>	<ul style="list-style-type: none"> <li>• The sales volume of this type of products is slightly increasing.</li> <li>• More countries are adopting national rules and maximum thresholds for the use of alcohol as a flavour-carrier.</li> </ul>
<p><b>Indefinite excise product code for wine and OFB</b></p>	<ul style="list-style-type: none"> <li>• Obstacle to monitoring and control, and risk of misclassification for a modest amount of products.</li> </ul>	<ul style="list-style-type: none"> <li>• In the absence of a revision of the OFB tax category, concrete problems of misclassification will remain negligible.</li> <li>• The issue would continue affecting market monitoring capacities of MS.</li> </ul>

## 2.2 Exemptions for denatured alcohol

### 2.2.1 Baseline assessment (inclusive of a market analysis)

Alcohol and alcoholic beverages can be subject to high excise duties in EU MS. However, a significant amount of alcohol is not produced and used for human consumption, but for other uses. Article 27 of Directive 92/83/EEC stipulates that Member States can exempt alcohol produced for certain uses from excise duty – but in order to prevent tax fraud or evasion (i.e. to eliminate the risk that alcohol intended for other purposes is sold as potable alcohol), the alcohol has to be denatured before it is sold. (NB: Article 27 also defines certain uses, such as the production of medicines, for which alcohol can be exempted even if it has not been denatured, but the focus of this Section is on denatured alcohol for industrial uses.) Denaturation consists in the addition of certain chemical substances that make the alcohol unfit for human consumption.

Article 27 includes two separate provisions for denatured alcohol, namely:

- Article 27(1)(a) concerns alcohol that has been ‘completely’ denatured in accordance with the requirements of any MS, provided that these have been duly notified and accepted by all MS.
- Article 27(1)(b) concerns what is often referred to as ‘partially’ denatured alcohol (although this term is not used in the Directive). It stipulates that alcohol denatured in accordance with the relevant national requirements and ‘used for the manufacture of any product not for human consumption’ shall also be exempted – but in this case there is no requirement for notification of or acceptance by the other MS.

The difference between the denaturing procedures that are allowed under the two indents, and the requirements that follow from them, is important. To summarise very briefly (for more detail see the Section on the regulatory framework below), ‘completely’ denatured alcohol (CDA) is exempt from excise duty *per se* and can be sold freely to anyone; a system of mutual recognition of denaturing procedures is intended to ensure it can circulate without obstacles throughout the EU, and the risk of fraudulent use is minimised. By contrast, the so-called ‘partially’ denatured alcohol (PDA) under indent 1 (b) can only be traded between authorised users, and the exemption is conditional on its use in the manufacture of another product. Its rationale lies in the fact that different industry sectors that use alcohol can have very different requirements, and in some cases, CDA is not appropriate (e.g. because its intentionally strong smell means it cannot be used in perfumes, tasting agents cannot be used with products such as toothpaste which come into contact with the mouth, etc.). Each MS applies its own criteria and regulations to determine which procedures and formulations for PDA are authorised.

#### 2.2.1.1 The market for denatured alcohol

Eurostat Prodcom data suggests a total sold production in 2015 of a little less than 1.3 billion litres of denatured alcohol. However, this data is not particularly useful for assessing the whole of the market, partly because figures for several MS (including some important alcohol producers such as DE and the UK) are missing.<sup>134</sup> Even more importantly, it is highly unlikely that the figures even for those MS for which they exist

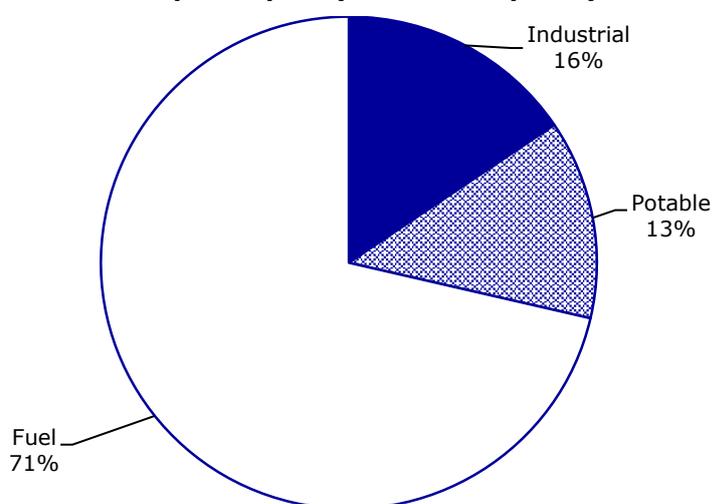
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<sup>134</sup> Eurostat Prodcom, Product code 20147500 - Denatured ethyl alcohol and other denatured spirits; of any strength. It should be noted that data for additional countries is available for different years (e.g. DE for 2016, UK for 2014), but the accuracy / comprehensiveness of this data appears questionable (i.e. likely to be too low). In any case, the (estimated) total for the EU28 does not change – between 1.25 and 1.28 billion litres per year.

are comprehensive, given that denaturing can happen at different stages of the production process, and a significant part of the alcohol that is denatured at some point or another may therefore never be declared as such.

It is therefore necessary to rely on other sources to estimate the market size and key trends. According to credible industry sources, total EU-28 alcohol consumption is a little over 7.5 billion litres per year.<sup>135</sup> Around 7 billion litres of this are produced within the EU, the rest is imported from third countries (imports into the EU have been on a downward trend since reaching a peak of almost 2 billion litres in 2011). The total consumption can be broken down into three main segments (Figure 5). Two of these (industrial, as well as fuel) are potentially relevant when it comes to assessing the market for denatured alcohol, while potable applications (which include alcohol used in the production of food products as well as vinegar) use exclusively *undenatured* alcohol, for obvious reasons.

**Figure 5 - EU alcohol consumption split by main uses (2014)**



**Source:** LMC International (2015).

Around 1.2 billion litres of **industrial alcohol** are consumed in the EU per year. This market is relatively stable, and only tends to register modest growth (or decline) more or less in line with the trajectory of the manufacturing industry as a whole. The majority of the alcohol used for industrial applications is produced from renewable sources (fermentation alcohol), while synthetic alcohol accounts for around 30-40%, with some fluctuations between the two primarily based on the relative price of the underlying raw materials. The main industrial uses of alcohol are as a solvent (which accounts for 70-75% of demand, and is used in the manufacture of a wide range of products including cosmetics, detergents, inks and coatings), and as a chemical intermediate (in order to produce other chemicals such as ethyl acrylates and ethylamines).

Most of the industrial alcohol used in the EU has to be denatured. Among the main uses, the exceptions where *undenatured* alcohol would typically (but not necessarily always) be used are pharmaceuticals (based on Article 27(1)(d) of the Directive; this accounts for approx. 10% of the industrial alcohol market) and chemical intermediates (based on Article 27(2)(d) or (e); this accounts for around 25% of the market).<sup>136</sup>

<sup>135</sup> The main source used for the ensuing analysis is LMC International, 'The European Market for Industrial and Potable Alcohol', 2015. Its main findings regarding the market size and evolution were confirmed by industry experts and stakeholders during interviews carried out in the context of this study.

<sup>136</sup> LMC International (2015).

This means that approx. 65% (800 million litres per year) of the industrial alcohol used across the EU is denatured, although the formulations, methods, and stage in the production process at which this happens can vary significantly, depending inter alia on the intended end use. Due to the diversity of uses and users, exact figures are not available, but based on existing sources and industry expert views, we estimate these 800 million litres are spread more or less evenly across the following key products:

- Cosmetics / personal care
- Automotive sector (anti-freeze, screenwash)
- Detergents and other cleaners
- Paints, coatings and inks
- Other (incl. biocides)

On the other hand, the **fuel market** has become the dominant use of alcohol in the EU in the last decade or so, especially so since the EU adopted its climate and energy package in 2009. There was a sharp increase in the production and use of so-called biofuels (which refers to mixtures of 'traditional' fossil-based liquid fuels – gasoline or diesel – with ethanol from renewable sources) until 2011, when EU fuel ethanol consumption had grown to around 5.5 million litres per year. It has been more or less constant since (partly as a result of low oil prices). The future market evolution is highly uncertain, and is likely to depend to a significant extent on the direction of renewable energy policy in Europe. The recent (2015) revision of the Renewable Energy and Fuel Quality Directives, which set a 7% ceiling to the contribution from conventional biofuels by 2020, was quoted as a concern by industry representatives. Just like industrial alcohol, in principle, all ethanol for use in biofuels has to be denatured, although, again, the formulations, methods, and stage in the production process at which this happens vary. In practice, the most common (but far from the only) procedure is the denaturing with a small amount of gasoline (or another fossil fuel) at a refinery, which then goes on to blend it with more of the same gasoline to produce the desired biofuel mix (e.g. 'E10' consisting of 90% gasoline and 10% ethanol).

The **price of alcohol** depends on a number of factors, including its grade / purity (the required standard varies depending on the intended end use), whether or not the alcohol is anhydrous (i.e. its water content minimised, which is necessary for many industrial as well as fuel applications), and, of course, factors related to supply and demand (such as the cost of relevant raw materials) as well as exchange rate movements. There has been a relatively high amount of price volatility in Europe in recent years, with the wholesale price of the cheapest grade (T2 fuel ethanol) fluctuating between about 60 and 90 US cents per litre between 2008 and 2015, and that of the most expensive grade (anhydrous industrial) between about 70 and 110 US cents per litre.<sup>137</sup> This means that EU denatured industrial alcohol market (approx. 800 million litres) is worth in the region of EUR 500-650 million per year, while the alcohol for biofuels market is estimated at around EUR 3-3.5 billion per year.<sup>138</sup> Refining, transport, storage, denaturation or any other additional costs charged by intermediaries or distributors are not included in these estimates.

**Table 27 – Estimated size of the EU market for denatured alcohol**

Application	Annual EU consumption (million litres)	Of which denatured		Price per litre (USD)		Exchange rate EUR-USD	Est. market value (million EUR)	
		%	Million litres	Min.	Max.		Min.	Max.
Industrial	1,200	65%	800	0.70	1.10	0.8	437	686
Fuel	5,500	100%	5,500	0.60	0.90	0.8	2,640	3,960
Total							3,077	4,646

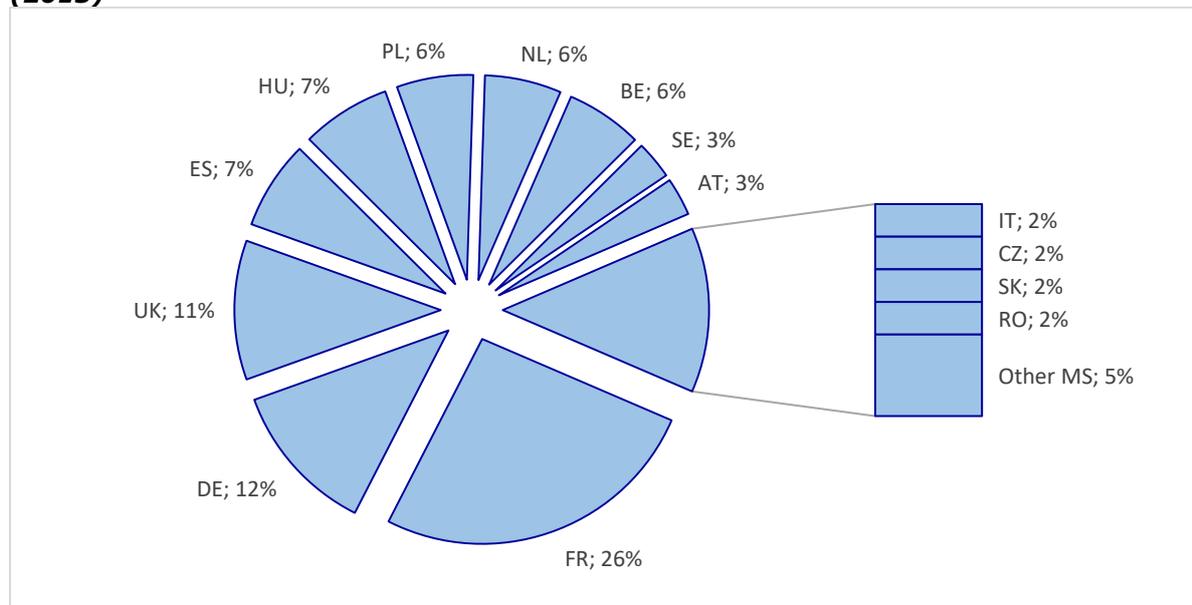
**Source:** Author's calculations based on LMC International.

<sup>137</sup> LMC International (2015).

<sup>138</sup> Applying an exchange rate of 0.8 EUR per USD, which is very close to the average over the last ten years.

The **production of alcohol** is distributed unevenly across the EU. Based on industry data, the total renewable ethanol production *capacity* was 8.9 billion litres per year (compared with an actual production of around 6.5-7 billion litres – see above).<sup>139</sup> France is by far the largest producer, followed by Germany and the UK (both of which are also important producers of synthetic alcohol, which is not included in these figures). Spain, Hungary, Poland, the Netherlands, and Belgium also produce significant amounts.

**Figure 6 – Member States shares of the total EU ethanol installed production capacity (2015)**



**Source:** Based on ePURE (2015).

The production in certain MS (such as Spain or Hungary) is destined almost entirely for use in biofuels, whereas others also produce significant amounts for industrial applications (in particular the UK and Germany, which are currently the EU's only producers of synthetic alcohol). It follows that some MS produce more alcohol than they use, while others need to look abroad to satisfy their demand. Looking only at industrial (not fuel) alcohol, the available data<sup>140</sup> for the period 2010-2014 suggests the MS with the most significant surplus were the UK (158 million litres per year, on average), France (126 million litres) and Poland (57 million litres), while the MS with the highest deficits were Germany (113 million litres), Belgium (80 million litres), Spain (68 million litres) and Italy (49 million litres). Overall, approximately a third of the industrial alcohol consumed in the EU each year (around 400 million litres) crosses intra-EU borders. Assuming the same ratios as above (65% of all industrial alcohol is denatured), this means approximately 260 million litres of the industrial alcohol that is denatured is produced in a MS other than the one in which it is used – though it is not clear from this data how much of this is denatured in the country of origin, and how much is denatured in the destination country (feedback from interviewed stakeholders suggest the latter is usually the case).

When considering the production, trade and consumption of non-potable alcohol, it is important to consider the **market structure**, distinguishing between two levels:

- On the one hand, there is the market for 'raw' (unrefined) alcohol, including the very large biofuels segment. This has most of the essential characteristics of a

<sup>139</sup> ePURE, 'European renewable ethanol – key figures 2015', 2016.

<sup>140</sup> LMC International (2015).

commodity, and the market is dominated by relatively few (around 100 according to industry experts) relatively large players who produce / deal high volumes, and several of whom have operations in several MS. At this level, there is a very significant volume of international trade, including imports from third countries to the EU as well as intra-EU trade, in particular movements from the production 'hubs' (especially France, but also the UK, Czech Republic, and others) to other Member States. The vast majority of this trade involves undenatured alcohol, which is moved under duty suspension from one tax warehouse to another, refined and/or denatured (where relevant) in the MS of destination, either by the recipient or the eventual end user.

- On the other hand, the market for industrial alcohol which has undergone varying degrees of rectification / purification (depending on the intended end use) is much more fragmented and involves a higher number (around 4,000 according to industry estimates) of economic operators both large and small from across a range of sectors, who sell or buy alcohol for specific uses, often in relatively small quantities and requiring specific denaturants. This market tends to be much less transparent, and more national or even local; while intra-EU trade does occur, it seems to be the exception rather than the norm, and the quantities of denatured alcohol that are moved from one MS to another appear to be very limited.

### 2.2.1.2 The regulatory framework

As briefly noted at the outset, the regulatory framework that exempts denatured alcohol from excise duty distinguishes between two different categories: completely denatured alcohol (CDA) and the so-called 'partially' denatured alcohol (PDA). The main EU and national rules and regulations applicable to both types are briefly summarised below.

For **completely denatured alcohol**, Article 27(1)(a) stipulates that MS shall exempt alcohol from excise duty:

*'When distributed in the form of alcohol that has been completely denatured in accordance with the requirements of any Member State, such requirements having been duly notified and accepted in accordance with paragraphs 3 and 4 of this Article. This exemption shall be conditional on the application of the provisions of Directive 92/12/EEC to commercial movements of completely denatured alcohol.'*

The process for notification referred to in the text requires each MS to communicate to the Commission the denaturants it wishes to employ; the Commission transmits this information to all other MS. The denaturing processes are then authorised by the Commission (provided no MS requests that the matter be raised in the Council) via a Commission Implementing Regulation.<sup>141</sup> In the past, MS typically notified between one and three procedures (or 'formulations') each. In 2008, due to the view that *'[t]he 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'*<sup>142</sup>, a Fiscalis Project Group (FPG) was created to explore the possibility of applying common denaturing procedures for CDA.

After the first phase of the project, the FPG proposed a formulation composed of 3 litres of methyl ethyl ketone (MEK – which serves as the 'smelling agent'), 3 litres of isopropyl

<sup>141</sup> Commission Regulation (EC) 3199/93, most recently modified by Commission Implementing Regulation (EU) 2017/1112.

<sup>142</sup> Commission Implementing Regulation (EU) 162/2013, recital 3.

alcohol (IPA – the chemical marker), and 1 gram of denatonium benzoate (the ‘tasting agent’) per hectolitre of ethanol. This formulation – often referred to as the ‘3-3-1’ formulation – was adopted on 1 July 2013 by Commission Regulation (EU) No. 162/2013. However, most MS chose to recognise this formulation in addition to (rather than instead of) their national formulations, only a few of which were withdrawn at the same time. In these circumstances, the uptake of the 3-3-1 Eurodenaturant formulation has been rather limited, with many economic operators indicating that it is too costly to produce and that the availability of MEK in the required quantities could be a problem.

In response to these criticisms, a revised version of the formulation was developed in the second phase of the FPG. It only contains one litre of MEK and one litre of IPA, and is therefore referred to as the ‘1-1-1’ formulation. This new formulation is widely supported by industry as well as a large majority of MS, most of whom have now also withdrawn their remaining national formulations. This means that, with effect from 1 August 2017<sup>143</sup>:

- 23 Member States<sup>144</sup> employ the new 1-1-1 Eurodenaturant;
- 4 Member States (BG, CZ, RO, UK<sup>145</sup>) employ the old 3-3-1 Eurodenaturant;
- 1 Member State (SE) employs a different variant of the Eurodenaturant ingredients, namely ‘1-2-1’;
- additionally, 3 Member States (CZ, EL, FI<sup>146</sup>) have kept one or two national formulations.

As noted previously, alcohol that is denatured in accordance with these procedures can be moved and sold freely anywhere in the EU (although there have in the past been issues with the interpretation of mutual recognition, which are discussed as part of the problem analysis below). The only condition stipulated in the Directive is the application of Directive 92/12/EEC (which has been repealed and replaced by Directive 2008/118/EC, the so-called Horizontal Directive), which effectively means that when moved between MS, CDA must be accompanied by a Simplified Administrative Document (SAAD).

For so called **‘partially’ denatured alcohol**, Article 27(1)(b) stipulates that MS shall exempt alcohol:

*‘When both denatured in accordance with the requirements of any Member State and used for the manufacture of any product not for human consumption.’*

Article 27(1)(b) essentially leaves it to MS to devise and apply rules and procedures for PDA that is used as an input for the manufacture of a product that is not intended for human consumption (rather than freely sold as a finished product in its own right). These provisions were originally included in the Directive primarily due to the specificities of the cosmetics / pharmaceutical industry (which uses alcohol in a large number of its products, and typically requires less drastic denaturing procedures), but they are also used for a number of other industrial applications. Unlike CDA, PDA is not exempt from excise duty *per se*; it has to be moved under the duty suspension regime, which implies storage and production in a tax warehouse, lodging of a guarantee, and the use of the Excise Movement Control System (EMCS), in accordance with the relevant provisions on the production, processing, holding and movement of excise goods in Directive

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<sup>143</sup> Commission Implementing Regulation (EU) 2017/1112.

<sup>144</sup> This includes Croatia, which has stipulated ‘a minimum of’ the 1-1-1 ingredients, but this clarification should have no effect in practice.

<sup>145</sup> BG and RO have recently communicated their intention to switch to 1-1-1 as soon as possible.

<sup>146</sup> In the case of Finland, the remaining national formulations are only authorised until the end of 2018.

2008/118/EC. Only when the manufacturing process is complete, the resulting product in which the PDA has been used is released for consumption.

The rules and regulations that apply to PDA, including the authorised denaturants and procedures, vary considerably between MS, and there is no mechanism for mutual recognition. Most MS have positive lists – some longer, some shorter – of approved formulations (for example, ES has approved 3 formulations, PL 9, and the UK 12). In many MS, the formulations are tied to a specific sector or end-use, while in others, the denaturants are not linked to any particular purpose. Some MS (including DE and ES) also provide for the possibility of authorising formulations other than those included in their positive list for individual users, based on an assessment of their particular needs and the inherent risks; at least one (FR) has no positive list at all and only authorises formulations for individual users on a case-by-case basis. Some MS' regulations (including DE, IT) explicitly state that PDA formulations that are authorised in other MS will usually also be authorised in their MS. In at least one MS (FR), the authorities can even authorise the use of ingredients of the final product itself (such as essential oils in the case of perfumes) as denaturants. Across the EU, it is estimated that several hundred formulations are authorised, though the exact number is impossible to ascertain due to the fact that authorisations granted to individual firms are typically not in the public domain. The JRC maintains a database of all formulations used across the EU, but this has not been systematically updated by the MS in recent years.

But it is not only the approved formulations, but also the requirements with regard to the supervision of the production, movement and use of PDA, that vary considerably between MS. Each country has its own system of registrations, licenses and authorisations for producers and users of alcohol. While the use of EMCS is obligatory for all cross-border movements, some (but not all) MS allow simplified procedures for movements of PDA within their own territory (based on Article 30 of Directive 2008/118/EC). There are also specific national rules regarding stock control, record keeping, inspections, etc. (some of which also apply to CDA). For example, ES requires the presence of a tax official during the denaturation process (who is to take three samples), and has defined a minimum of 100,000 litres per process. PL has introduced new legislation in 2017 which provides for a full value chain control for domestic and intra-EU transport of certain goods, including alcohol. Some MS (including DE, ES, FR) also allow for so-called 'in situ' denaturation, meaning users (typically cosmetics manufacturers) can buy undenatured alcohol and denature it on their own premises, sometimes as part of the production process itself.

Overall, it is clear that certain approaches are stricter in some MS than in others, based partly on their respective assessments of the risks involved. During the interviews conducted as part of this study, officials and stakeholders in MS that are relatively flexible regarding the denaturing formulations they allow tended to emphasise the fact that any potential risks arising from this are mitigated by the strict controls of the production process.

### **2.2.1.3 The uses of CDA and PDA**

Comprehensive data for how much CDA and PDA is produced and used across the EU does not exist. While there are some 'typical' uses (for example, the cosmetics sector uses primarily PDA, whereas CDA is widely used for screen wash), there are no 'hard and fast' rules. Overall, it appears that the amount of PDA produced and used across the EU by far exceeds that of CDA, but there are regional variations, as which of the two types is used for which end uses depends to some extent on the CDA and PDA formulations that are approved in the MS in question. It is also worth noting that the changes in the CDA formulations that come into effect from 1 August 2017 (see above) may lead to a further shift in the balance for certain products / countries.

Across most of Western Europe (including DE, ES, FR, UK), CDA only accounts for a small minority of all denatured alcohol. Apart from being sold in relatively modest quantities to the general public (primarily as a fuel for alcohol burners, camping stoves or barbecues, or as a household cleaning agent), CDA is used for the manufacture of a limited range of products, in particular for use in the automotive industry (anti-freeze, screen wash). Economic operators interviewed for this study estimated that CDA accounts for no more than 5-10% of all industrial alcohol in the 'older' (EU-15) MS. This is broadly in line with the responses of those EU-15 national authorities that were able to provide data on the volumes of CDA and PDA produced as part the 2015 evaluation.

However, the situation in Eastern Europe is markedly different, and CDA plays a much more important role in the 'newer' MS (which, taken together, account for around 15% of the industrial alcohol consumption in the EU<sup>147</sup>). According to data compiled for the evaluation, the volume of CDA produced is greater than that of PDA in CZ, EE, PL, SI and SK, and only slightly smaller in BG (no other EU-13 MS provided this data). This is likely to be due to comparatively strict rules for PDA (in terms of approved formulations and/or supervisory regimes) which make the use of CDA relatively more attractive. For example, the cosmetics industry in PL uses primarily CDA in its products (some of it imported from other MS). Although this was described as less than ideal by the interviewed industry representatives (and the cosmetics industry in Western Europe uses almost exclusively PDA), it was reportedly preferable to the alternative of using PDA in PL and complying with the requisite requirements. Overall, we estimate that the market for industrial alcohol in the EU-13 is currently around 60-70% CDA and 30-40% PDA, with some significant variations between MS. This means that, for the EU as a whole, we estimate the market for denatured industrial alcohol is around 84% PDA, and 16% CDA (see Table 28 below).

Biofuels are another interesting case. Most MS have specific PDA formulations for ethanol for use in biofuels, which usually involves denaturing with gasoline or ethyl tert-butyl ether (ETBE). At least one MS (DE) specifically prohibits the addition of any other 'alien' denaturants in biofuels. However, at least one MS (CZ) uses CDA for its domestic biofuels production, and has a specific CDA formulation for this exclusive purpose, which it intends to keep using in future alongside the Eurodenaturant. Nonetheless, given that no other MS have notified their intention to keep national CDA formulations for this purpose, it appears safe to assume that, from 2018, around 98% of biofuels in the EU will be produced using PDA. This typically means the alcohol is denatured with a small quantity of gasoline, before being blended with more gasoline; or denatured with a small quantity of ETBE before being transformed entirely into ETBE (which is an alternative biofuel additive). Some MS allow the two steps (denaturing / blending) to actually be carried out at the same time, as part of the same process, so that, effectively, undenatured alcohol is mixed with gasoline and the resulting product is considered an energy product.

**Table 28 – Estimated amounts of PDA and CDA consumed annually in the EU**

Application	Geography	Annual consumption of denatured alcohol (mn litres)	% PDA (est.)	% CDA (est.)	Amount PDA (mn litres)	Amount CDA (mn litres)
Industrial	EU-15	680	92.5%	7.5%	629	51
	EU-13	120	35%	65%	42	78
	EU-28	800	84%	16%	671	129
Fuel	EU-28	5,500	98%	2%	5,390	110
<b>Total</b>	<b>EU-28</b>	<b>6,300</b>	<b>96%</b>	<b>4%</b>	<b>6,061</b>	<b>239</b>

**Source:** Author's estimates based on various sources incl. LMC International.

<sup>147</sup> LMC International (2015).

## 2.2.2 Problem analysis

The 2015 evaluation and subsequent analysis identified a number of problems with the exemptions for denatured alcohol, since both Articles 27(1)(a) and (b) 'lack clarity regarding which products can be exempted under which conditions', which can lead to inconsistencies, uncertainties, financial and commercial risks, and – 'theoretically at least' – competitive advantages for economic operators in certain MS over others.<sup>148</sup> As part of this study, we have aimed to substantiate and collect further evidence on the actual problems and the extent to which they generate negative impacts in practice.

### 2.2.2.1 Incomplete / inconsistent mutual recognition of CDA

The wording of Article 27(1)(a) of the Directive is somewhat unclear: it stipulates that MS have to exempt alcohol that has been completely denatured in accordance with the requirements of *any* MS. Since the requirements of MS vary, this raises the question of whether producers in a given MS can use the CDA formulations of a MS other than their own, and whether other MS are required to recognise CDA produced anywhere in the EU (and potentially beyond) using any of the notified formulations or not.

The responses by national administrations to these questions have varied. While it is universally accepted that MS are obliged to exempt CDA produced in another MS in accordance with the formulations notified by that same MS, the situation is less clear when the formulations of another MS are used. This has led to a significant amount of legal uncertainty in the past, which has sometimes had an effect on certain business decisions, as illustrated by the following examples reported by stakeholders consulted as part of this study:

- Around 2008/2009, significant amounts of alcohol were denatured in DE using the national CDA formulation of LV, and subsequently moved to PL for use in a variety of industrial applications. The practice was stopped following a complaint by PL, which did not consider that formulations other than those notified by the producing MS itself qualified as CDA.
- DE has now accepted the interpretation that only alcohol that has been completely denatured in a given MS in accordance with the requirements of the same MS are to be treated as CDA, even though this means, for example, that the same product – e.g. alcohol denatured according to the DE CDA formulation – needs to be treated differently depending on where it was denatured: if in BE or FR, for example, and then moved to DE, it is considered PDA, whereas if it is denatured in DE itself, it is treated as CDA.
- As noted previously, cosmetics producers in PL frequently use CDA imported from HU, which the PL authorities have to recognise as CDA, even though the same product would not qualify as CDA if produced in PL itself.

Questions such as these have been cause for significant concerns, especially in the decade from the 2004 EU enlargement round until about 2013, when the matter was discussed in the Excise Committee, and the Commission clarified its view that the national CDA formulations relate only to the MS that have notified them, respectively, and it is not permitted to use another MS's method. This was broadly confirmed when, in 2014, FR, having previously notified only the 3-3-1 Eurodenaturant,<sup>149</sup> notified the Commission of its intention to also apply the national procedures notified by DE and HU. However, during the Excise Committee meeting where this was debated, the Commission as well as the majority of MS were not in favour of this proposal, insisting

<sup>148</sup> Ramboll Evaluation (2016), p. 77-78.

<sup>149</sup> See Commission Implementing Regulation 162/2013.

that a situation where MS *de facto* allowed their economic operators to use other MS' formulations, without having notified these itself, would be problematic.

Since then, most MS seem to have accepted this interpretation, and in the interviews with stakeholders for this study, we have not found any evidence of divergent interpretations that cause any legal uncertainty at the present time – even though the MS questionnaire responses to the 2015 evaluation seem to indicate the divergent approaches have not yet disappeared completely. This also concerns imports from third countries, for which some MS allow the use of the formulation notified by any MS, whereas they take a more restrictive approach to CDA made in another MS. However, extra-EU imports are subject to an import tariff of EUR 10.2 per hl, and the value of all imports of denatured alcohol into the EU typically amounts to only around EUR 20 million per year;<sup>150</sup> CDA is likely to only account for a fraction of this, and unfair competition from abroad was not raised as a concern by any stakeholders interviewed for this study.

### **Box 11 – Results from the OPC: experienced issues with CDA**

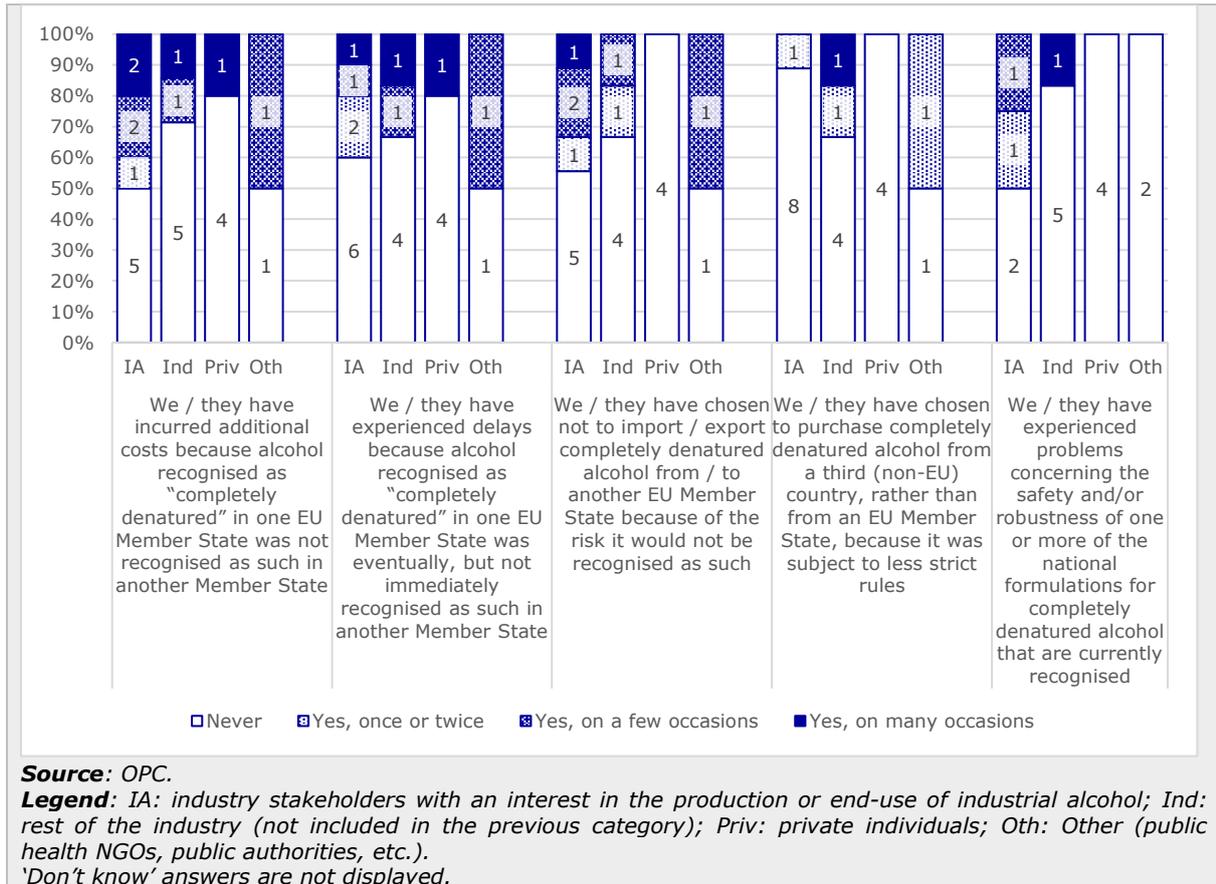
In their responses to the open public consultation:

- 9 respondents (out of 58 who answered this question, including 'don't know' answers not displayed below) indicated they, and/or a company that they had done business or were in direct contact with, had incurred additional costs because alcohol recognised as CDA in one EU MS was not recognised as such in another MS, on one or more occasions.
- 8 respondents (out of 57) indicated they or another company had experienced delays because alcohol recognised as CDA in one EU MS was eventually, but not immediately recognised as such in another MS.
- 7 respondents (out of 58) indicated they or another company had chosen not to move CDA from / to another EU MS because of the risk it would not be recognised as such.
- 4 respondents (out of 58) indicated they or another company had chosen to purchase CDA from a third (non-EU) country, rather than from an EU MS, because it was subject to less strict rules.
- 3 respondents (out of 57) indicated they or another company had experienced problems concerning the safety and/or robustness of one or more of the national formulations CDA that are currently recognised.

The question on the issues related to completely denatured alcohol received a relatively low degree of attention, with no more than 10 responses from each of the selected respondents' groups. Taking the low response rate into consideration, the various issues under consideration do not seem to occur for the majority of respondents.

**Question #46** - *Have you, the company you represent, and/or a company that you have done business with or are in direct contact with, ever experienced any of the following issues related to completely denatured alcohol (as regulated by Article 27(1)(a) of the Directive)?*

<sup>150</sup> Eurostat trade database, CN code 2207 20 00 (Ethyl alcohol and other spirits, denatured, of any strength).



To sum up, in the recent past differing interpretations of what constitutes mutual recognition as regards CDA formulations have led to uncertainty for economic operators. This could have had cost implications for some who might have seen their attempts to move CDA from one MS to another frustrated (meaning they would have had to either pay excise duty or move it as PDA instead), or had to adapt their business models in response to changes in the interpretation of the applicable rules (such as the decision by DE to no longer allow its economic operators to produce CDA using formulations notified by other MS). The costs arising from this are impossible to quantify, as they are so dependent on the specific case in question, and we do not have a complete picture of all relevant flows of CDA between MS.

But in any case, the adoption of the 1-1-1 Eurodenaturant as their *only* CDA formulation by 22 MS – in all likelihood soon to be 25 (BG and RO have also now notified their intention to use this formulation, and FI phases out its remaining national formulation by end 2018) – means that any remaining problems with mutual recognition will soon be greatly diminished. This would leave only CZ, SE and UK requiring different concentrations of the Eurodenaturant ingredients, and only CZ and EL still using a distinct national formulation. These remaining national formulations are for very specific purposes (biofuels production in the case of the CZ ones), and all stakeholders who were consulted indicated that there was no demand for these formulations in other MS, and therefore no intention to move them across borders and no risk of any issues around mutual recognition. Concerning the MS that insist on higher concentrations of the Eurodenaturant ingredients for their domestic producers (CZ, SE, UK), feedback from the competent national authorities suggests they understand and accept that they will be obliged to recognise 1-1-1 CDA produced in other MS (even though this will obviously put their own producers at a competitive disadvantage). Movements in the other direction (of 3-3-1 or 1-2-1 CDA to MS that use the 1-1-1 formulation) make no economic sense and, even if they did happen, would cause no problems, as 'overdenatured' alcohol is recognised.

Therefore, even though the wording in the Directive continues to be somewhat ambiguous, it is very unlikely that mutual recognition of CDA will continue to cause problems in practice going forward, as national formulations have largely disappeared. In theory, this could change again in future, as MS are still free to notify any procedures they wish. But this appears very unlikely in the current circumstances, unless potential issues with the 1-1-1 Eurodenaturant for certain uses were to come to light, for which there are no indications at present. Nonetheless, stakeholders interviewed for this study identified the following potential risks / drawbacks:

- Some MS (CZ and UK) that have chosen to stick with the 3-3-1 Eurodenaturant have expressed concerns regarding the robustness of the reduced concentration, and therefore the potential for an increased fraud risk. Their main argument is that the lower amount of MEK means the smell is less prominent and can more easily be masked by the addition of other substances such as fruit flavourings. However, many MS disagree on that issue, and tests undertaken by the JRC have shown that, in any case, MEK is relatively easy to remove, and its concentration is therefore of limited relevance. More importantly, the presence of IPA as a chemical analytical marker that is very difficult / costly to remove (even in the reduced concentration of 1L per hl of alcohol) means the 1-1-1 Eurodenaturant is more 'robust' than the CDA formulations that were most widely used across the EU in the recent past, in particular the German and Hungarian formulations (both of which also only contained 1L of MEK, and no IPA).<sup>151</sup>
- One economic operator who produces screen wash and anti-freeze with the 'old' DE CDA formulation noted that IPA has not yet undergone long-term tests in these products, and that if any issues were to arise with its compatibility with polycarbonates, this would cause significant problems and might force producers to resort to explore alternative formulations. It should be noted, however, that tests organised within the context of the FPG and carried out by DEKRA in 2015 revealed that a screen wash containing the 3-3-1 Eurodenaturant did not have any detrimental effects upon car components.<sup>152</sup>
- As noted above, some of the 'old' national formulations were used for 'unorthodox' purposes (e.g. HU CDA for PL cosmetics) for which the Eurodenaturant may not be appropriate. This could result in additional costs for economic operators having to switch to alternative PDA formulations, which could in theory lead to demands to bring back certain national CDA formulations.
- At approx. EUR 2-5 per hl of alcohol, the price of the Eurodenaturant is higher than that of some of the 'old' national CDA formulations (for example, the old DE and HU formulations did not contain IPA, while the old SI formulation contained IPA but no MEK). While the price of the ingredients in the 1-1-1 concentration<sup>153</sup> is not currently viewed as a significant concern by industry (unlike the previous 3-3-1), the increased demand for certain ingredients that will now be required for CDA across all MS could potentially push their price up.

In summary, the introduction of the Eurodenaturant, and the elimination of almost all national CDA formulations, have significantly reduced the uncertainties around mutual

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<sup>151</sup> Eric Aries, Fernando Cordeiro, Alain Maquet, Ana Boix, Boleslaw Slowikowski, Christof Von Holst, 'Eurodenaturant project – Phase II', 2016 (not published).

<sup>152</sup> Ibid.

<sup>153</sup> According to industry experts, the cost of IPA fluctuates between about EUR 1-3 per l; that of MEK between about EUR 1-4 per l; and that of denatonium benzoate is relatively stable, at about EUR 0.10 per g. Fluctuations can occur due to a range of market (supply and demand) factors.

recognition and concrete problems caused by this. And while the Directive in its current form allows MS to re-introduce national CDA formulations, this appears very unlikely at present.

#### **2.2.2.2 Proliferation of national approaches to PDA**

The system for PDA is essentially non-harmonised. Directive 92/83/EEC clarifies that alcohol that is denatured and used for the manufacture of any product not for human consumption shall be exempted from excise duty, but leaves it to MS to define the denaturation requirements. Given that (unlike with CDA) the exemption is conditional on its use, the 'partially' denatured alcohol needs to be moved under duty suspension. Once the manufacturing process is complete, the products containing the PDA are released for consumption across the EU. This means that MS do not necessarily have to recognise each other's denaturing requirements, but they do need to exempt the *products* made using PDA from excise duty independently of where in the EU they were produced.

As noted previously, MS' regulatory and administrative frameworks for PDA vary significantly regarding the procedures and formulations they have authorised (sometimes just a few, sometimes hundreds); the process for obtaining authorisations (in some MS this is limited to the formulations on the official published list, whereas others can authorise formulations 'ad hoc' for individual economic operators); and the system for supervising the production, movement and use (including registration and record keeping requirements, samples to be taken, presence of customs officials during parts of the process, rules for so-called in-situ denaturation, etc.). While the need to use EMCS for goods moved under duty suspension is common to all MS, these are free to define the financial guarantees required (meaning these can vary significantly; e.g. in the CZ they amount to a little over EUR 10 per litre of alcohol, which is the equivalent of the excise duty rate for ethyl alcohol), and some have opted to use simplified procedures for movements within their own territory.

The interviews conducted as part of this study confirmed that the vast majority of both national authorities and economic operators agreed that there are good reasons to allow MS to define their own rules for PDA. The main reasons cited for this were the flexibility the system affords MS to apply rules that best meet the needs of their industry (which vary significantly from sector to sector), while reducing the risk of fraud to a level that is deemed acceptable by the MS in question (noting that this risk varies from MS to MS, due to geographical, socioeconomic and cultural factors as well as, importantly, the excise duty rates applicable to alcoholic beverages – high rates obviously create greater incentives to commit fraud). There is therefore widespread agreement that a one-size-fits-all approach for PDA across the EU would be difficult to agree and may create significant problems for certain MS and/or sectors.

At the same time, it is clear that the lack of harmonisation (including the proliferation of national PDA formulations, as well as other elements of the supervisory regime) does mean that, while the single market for *products containing PDA* is guaranteed (so that, for example, perfume made in FR containing PDA in accordance with the FR requirements can be sold freely across the EU), the same is not entirely the case for PDA itself. While PDA made in a given MS in accordance with its national requirements can be moved to another MS using EMCS (in the same way that undenatured alcohol can be moved), it will not be recognised as legally denatured, and therefore cannot be exempted from excise duty when used for the manufacture of products, unless it also complies with the formulation and authorisation requirements of the receiving MS (which may be different). The following sub-sections discuss specific problems that may arise from the proliferation of national rules, including the extent to which these are due to the EU-level regulatory framework (as opposed to purely national rules).

➤ **COMPLIANCE, ADMINISTRATIVE AND OTHER OPERATING COSTS FOR BUSINESSES**

The different supervisory regimes obviously result in compliance and administrative costs for producers and users of PDA, which can vary significantly from MS to MS. Stakeholders interviewed as part of this study (including economic operators with activities in more than one MS) pointed to a number of ways in which the regimes in certain MS were found to be especially burdensome, such as extensive administrative requirements and high financial guarantees / bonds. For example, interviewees in PL noted that it is common for users of PDA in PL to have a full-time member of staff dedicated entirely to ensuring compliance with the regulatory framework, and companies prefer to use CDA wherever possible to avoid the burdens that come with using PDA.

In addition to the costs of complying with the supervisory regimes and providing the required information to national authorities, there can also be other operating costs that arise from what procedures can and cannot be used in different MS. For example, cosmetics companies in some MS have access to a much wider range of PDA formulations and production procedures (including in situ denaturation) than those in others. This can mean that the manufacture of certain products (e.g. fine fragrances) is possible to a higher standard and/or at lower costs in certain MS, which in turn can have an influence on business decisions and, ultimately, profits.

Multinational companies may be able to take advantage of such differences and locate the production of certain goods in those MS that offer the most favourable conditions as regards PDA formulations and related factors. On the other hand, there are also instances where multinationals with operations in several MS claim to incur additional costs, as they need to adapt the formulations and production processes for otherwise identical products containing alcohol to the respective national PDA rules.

The costs arising from the national regulatory frameworks vary significantly from MS to MS, from sector to sector, and even from company to company, and would therefore be very difficult to estimate comprehensively. In any case, the costs arising from these aspects are not attributable to the Directive, but to national implementing rules, and were therefore not assessed in detail as part of this study.

➤ **BARRIERS TO INTRA-EU TRADE**

A related but conceptually different problem, which is potentially more relevant in the context of the current review, is the extent to which the lack of harmonisation represents a barrier to intra-EU trade in PDA. The existence of different national rules and regulations generally represents an obstacle to trade. Economic operators who intend to move PDA from one MS to another need to ensure they comply with the rules that are applicable in all relevant jurisdictions. Since the rules are frequently complex and divergent, this can be a daunting task. There is also the financial risk of 'getting it wrong', which could result in having to pay excise duties.

An additional factor that may make certain economic operators disinclined to source PDA from another EU MS is the need to comply with the requirements of Directive 2008/118/EEC for the movement of goods under duty suspension. This includes the obligation for users to have a tax warehouse and to be connected to EMCS in order to be able to receive PDA from another EU MS. A reluctance to do so was mentioned as one of the main reasons why many users of denatured alcohol (especially small ones) prefer to either buy PDA in the domestic market, or use CDA where possible. While EMCS was described by those who do use it as functioning very effectively and having resulted in a major reduction of burdens (compared with the previous 'manual' procedures), smaller firms are reportedly often reluctant to sign up to EMCS due to the required up-front investment and the perceived need to 'open up' vis-à-vis customs to a greater extent than they are comfortable with. At the same time, it is important to note that, unless a

MS has chosen to use simplified procedures (such as DE, UK), the use of EMCS is obligatory even for domestic movements of PDA, which means that in many MS sourcing PDA abroad would not incur any additional costs related to the movement under duty suspension.

The interviews with economic operators conducted for this study revealed a mixed picture as regards cross-border trade in PDA. While most interviewees acknowledged the fact that the different procedures and regimes in each MS *can and do* make cross-border trade more difficult, none of the interviewees felt this had affected them in a significant way, or were able to point to instances where they had incurred unforeseen costs. Their companies either were able to sell and/or buy alcohol across the EU, or felt there was no business need / incentive for them and/or their customers to do so. Many larger producers and distributors of alcohol for use in industrial applications and/or biofuels do move significant quantities of both partially denatured and undenatured alcohol between MS under duty suspension using EMCS, and reported no significant problems with this in the large majority of cases. The prevailing view was that such movements are generally possible without major difficulties, although they do require a certain level of investment in storage facilities (including tanks for different types of denatured alcohol, and in setting up and maintaining a tax warehouse) and in understanding and complying with the applicable rules in the different MS (which, again is more difficult and costly in some MS than in others). Large, specialised companies for whom alcohol is a key product often find it worth making this investment (but interviewees were unable to provide detailed cost estimates). On the other hand, smaller players with limited resources typically prefer to buy domestically, and let someone else deal with the complexities stemming from international trade in PDA.

#### **Box 12 - German economic operators' cross-border trade in PDA**

To illustrate the above, it may be useful to consider the example of Germany. Although Germany is the second largest EU producer of both renewable and synthetic alcohol, it purchases significant amounts of alcohol abroad, mainly from neighbouring MS, to meet the needs of its industry and transport sectors. There are a number of producers of industrial grade alcohol in Germany who rectify alcohol produced both domestically and abroad (in which case it is nearly always moved to Germany undenatured), and supply it to customers from a range of sectors, often in denatured form. Some of these focus completely on the domestic market, and reported that smaller customers in particular usually prefer to buy locally, so as to avoid having to use EMCS (Germany allows simplified procedures for domestic movements) and eliminate any potential risks and uncertainties that may stem from dealing with foreign suppliers.

However, other German producers do supply customers in a range of MS, including, in some cases, with PDA made according to the requirements of those MS. This requires the producer to obtain an authorisation from the German authorities to use the formulation in question, which is reportedly unproblematic as the German regulation explicitly states that an authorisation is granted for denaturants that are demonstrably authorised in another MS, unless this would conflict with fiscal or health concerns. When it comes to moving the PDA, it reportedly makes little difference in practice for the supplier if and how the alcohol is denatured, as anything that is not CDA is subject to the duty suspension regime anyway. As long as the foreign customer has the required licenses and authorisations from the competent authorities in their MS, has a tax warehouse and is connected to EMCS, the German supplier can send whatever type of alcohol the customer orders (provided German customs have authorised it).

Nonetheless, the frequent lack of transparency regarding the formulations authorised in each MS was described as a challenge (as it makes demonstrating what is authorised where difficult and time-consuming). At the same time, it was also noted that there are differences depending on the MS in question: the supervisory regimes in certain MS (such as CZ, FR) were reportedly especially strict towards foreign producers, and as a result German producers found it was not viable to supply potential customers there due to the burdens they faced.

Another poignant example is that of a cosmetics firm that manufactures products in two different MS. For their production in FR, they buy alcohol and denature it in situ (i.e. within their premises as part of the manufacturing process), all within FR. But for their production in ES, they purchase PDA produced in FR in accordance with the

requirements of ES, and then move it to their tax warehouse in ES. Although this system required an initial investment in time and effort to ensure compliance, the company reported it now runs smoothly, and that the differences between the requirements of the two MS do not cause any significant problems in practice.

French producers of denatured alcohol confirmed this, although the need to obtain a specific authorisation from the FR customs authorities results in delays of typically around one month before the PDA can be supplied. This further confirms that intra-EU trade in PDA is certainly possible and does happen, although the investment required to make it work is likely to prevent many smaller firms from trying. At the same time, it is important to distinguish between two groups of MS:

- MS (including those referred to in the examples above, namely DE, ES and FR) that authorise specific denaturants / formulations (other than those contained in the positive list, if one exists) based on applications from individual firms: Producers as well as users in these MS generally find it relatively easy (certain complexities and associated costs notwithstanding) to sell or buy PDA to / from other MS, as their authorities are prepared to authorise foreign formulations in specific cases.
- MS that only authorise denaturants / formulations that are included in a positive list (including CZ, PL, UK): Producers based in these countries would find it much more difficult to supply customers abroad with PDA (unless the authorised formulations in both MS happen to coincide). Users of PDA could potentially buy from a supplier in a MS that is part of the first group.

In summary, it is clear that the existence of different national procedures and supervisory regimes does inhibit cross-border trade in PDA to a certain extent, which varies depending on the MS, sector, and types of companies involved. Operators in MS that follow a flexible approach to authorising formulations are far better able to do business across borders than those that define the requirements more strictly. In either case, smaller users of PDA typically prefer to source PDA domestically, which is partly due to the rules concerning denatured alcohol, but also partly due to other factors (cultural, administrative, linguistic etc.) that make some companies reluctant to internationalise. This in turn creates business opportunities for pan-European distributors, who source undenatured alcohol from across the EU, and denature it in accordance with the respective national requirements in their tax warehouses in the different MS in order to supply local customers.

However, any negative economic effects on firms who choose (or feel obliged) to purchase PDA from domestic suppliers are likely to be minimal, as the well-functioning EU market for raw / undenatured alcohol (see above) means the prices are very similar across the EU.<sup>154</sup> And since alcohol is a relatively inexpensive product (prices are typically less than EUR 1 per litre even for the most expensive types), transport costs are a significant factor, meaning it is rarely worth moving denatured alcohol over long distances anyway (except in very large quantities). Therefore, it can be concluded that, although there certainly are barriers, and there may be isolated cases with non-negligible cost implications (especially if the requirements are not fully understood at the outset, and/or the authorities of the MS involved follow very different approaches), overall, the extent to which difficulties in trading PDA across border results in additional costs for users of denatured alcohol is very limited.

**Box 13 – Results from the OPC: experienced issues with PDA (direct use)**

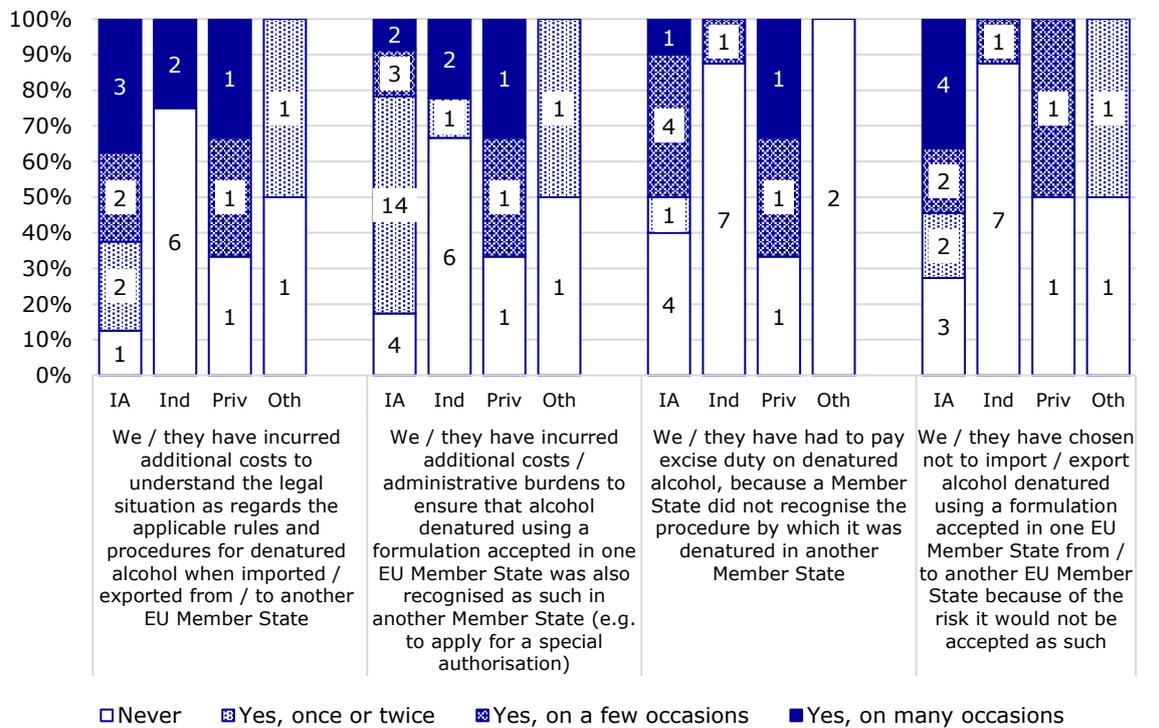
<sup>154</sup> According to LMC International (2015), average regional prices in different EU regions varied by only around 5% at most, with slightly higher prices in Southern and Eastern Europe.

In their responses to the open public consultation:

- 12 respondents (out of 71 who answered this question, including 'don't know' answers not displayed below) indicated they, and/or a company that they had done business or were in direct contact with, had incurred additional costs to understand the legal situation as regards the applicable rules and procedures for PDA when moved from / to another EU MS, on one or more occasions.
- 25 respondents (out of 71) indicated they or another company had incurred additional costs / administrative burdens to ensure that PDA using a formulation accepted in one EU MS was also recognised as such in another MS (e.g. to apply for a special authorisation) – though 16 of the 25 stated they had only experienced this on a single occasion.
- 9 respondents (out of 71) indicated they or another company had had to pay excise duty on PDA, because a MS did not recognise the procedure by which it was denatured in another MS.
- 11 respondents (out of 71) indicated they or another company had chosen not to move PDA from / to another EU MS because of the risk it would not be accepted as such.

As in the previous case, the following question on the issues related to partly denatured alcohol attracted a limited number of responses. The only issue that received greater attention from the industry was that of the additional costs and administrative burdens to ensure that alcohol denatured using a formulation accepted in one MS is also recognised in another Member State, which was however described as quite rare, having happened only once or twice.

**Question #49** - Concerning Article 27(1)(b): Have you, the company you represent, and/or a company that you have done business with or are in direct contact with, ever experienced any of the following issues related to denatured alcohol as regulated by Article 27(1)(b) of the Directive?



Source: OPC.

Legend: IA: industry stakeholders with an interest in the production or end-use of industrial alcohol; Ind: rest of the industry (not included in the previous category); Priv: private individuals; Oth: Other (public health NGOs, public authorities, etc.).

'Don't know' answers are not displayed.

➤ **COMPETITIVE DISTORTIONS**

Again, the fact that PDA producers and users in different MS have to comply with different supervisory regimes (some of which are stricter in certain areas than others), and have access to different PDA procedures and formulations, can have cost implications, as well as affect the quality of certain products (see the Section on compliance and other operating costs above). In theory, this distorts competition, and

may give economic operators in certain MS an unfair competitive advantage over those in other MS. For example:

- Cosmetics producers in FR are able to use a range of procedures (including in situ denaturation with ingredients of the final product) that companies in most other MS cannot (provided the FR authorities consider these procedures to be sufficiently robust in the specific case in question, taking into account all relevant factors). This does mean that, for the production of fine fragrances in particular, the conditions in FR are more favourable than in most if not all other MS (this impression was confirmed by cosmetics producers with first-hand experience of the systems in different MS).
- Alcohol producers in DE are better able to supply foreign customers with PDA than producers in most other MS, since the German authorities usually authorise the use of formulations that are demonstrably authorised in another MS on an individual basis.

However, it is important to note that PDA regulations and the associated costs and opportunities are only one of a range of factors that affect business decisions and performance. Thus, cosmetics firms that are active in other MS (in some cases, as well as in FR) pointed out that aspects such as regulation in other areas, labour costs, supply chains, proximity to customers etc. mean that favourable PDA regimes can be balanced out and sometimes overridden by disadvantages in other areas. While several of the economic operators that were interviewed were critical of specific aspects of the national rules and procedures they deemed disproportionately burdensome in comparison with other MS, they agreed that the origin of the problem was not the Directive as such, but the national legal and administrative framework, which in turn reflects the way the authorities in different MS assess the risks arising from the production, storage, movement and use of denatured alcohol.

#### ➤ **ENFORCEMENT COSTS FOR PUBLIC AUTHORITIES**

Another concern arising from the proliferation of national PDA formulations is the burden this may cause for public authorities in the MS, in particular tax / customs laboratories who are tasked with analysing and trying to determine the origin of potentially fraudulent products. Fraud risks and their potential impacts on tax revenues and/or public health are discussed in a separate Section further below; here, we focus exclusively on enforcement costs stemming from the current PDA regime.

In their questionnaire responses to the 2016 evaluation, a minority of MS indicated they felt that the existence of various denaturing methods across the EU made it 'particularly difficult' for their administration to monitor and control of the production and/or movement of denatured alcohol. The most frequent reason cited for this response was a lack of knowledge of the different denaturing methods used by other MS, resulting in a burden on the time and resources available for analysis in the laboratories. During the interviews conducted as part of this study, the tax / customs authorities in the Western European MS where fieldwork took place (DE, ES, FR, UK) reported no problems with this – their laboratories routinely carry out analysis in the context of applications for new PDA formulations and/or samples from denaturing processes carried out within their respective MS, but in all of these cases the denaturants used are known so the analysis is not particularly difficult or burdensome. It was noted that analyses of PDA arriving from other MS are not necessary, as from a fiscal point of view it does not matter how the alcohol was denatured: if the formulation is not compliant with the procedures authorised by the receiving MS, the product is not recognised as PDA and therefore not eligible for an exemption.

The responses from MS in Central / Eastern Europe (CZ, PL) helped clarify the situation. Even though fraud with denatured alcohol is a much more significant concern in these countries, they agreed with their Western counterparts that tests on PDA moved from another MS (or imported from a third country) are not usually required. However, when suspicious products (i.e. illicit alcoholic beverages that may have been produced using denatured alcohol) are found, the laboratories need to try to ascertain their origin. Thus, the number of tests that are required is directly linked to the fraud risk, which is reportedly close to zero in some MS (whose laboratories therefore report no burdens – see above), but significant in others (for details see the Section on fraud below). And the fact that the list of possible legal denaturants across all EU MS is so long means these tests can be more difficult and costly than if the laboratories only had to check for a limited number of ingredients to determine where and for what purpose the alcohol may have been denatured.

According to data provided by the authorities of the two afore-mentioned MS, alcohol can account for up to 25-50% of the workload of their customs laboratories, though this includes routine tests on samples of alcohol denatured in the MS itself with known denaturants. In recent years their laboratories have typically analysed several hundred samples of denatured alcohol;<sup>155</sup> however, only a small minority of these would be of the 'difficult' variety related to suspicious alcoholic beverages that may contain (cleaned up) denatured alcohol of unknown origin. In extreme cases, when nothing is known about the possible origin and denaturants, the tests can reportedly be very time and labour intensive (i.e. take several days, and cost up to EUR 1,000 in staff time and materials), and do not always lead to a conclusive result. If we assume around 500 tests of alcohol samples per year, and that around 5% of these are 'difficult' in the sense outlined above, the total annual cost for a given national customs authority would be in the region of EUR 25,000.

### **2.2.2.3 Divergent interpretation of the terms of Article 27(1)(b)**

Another matter that is causing certain problems is the lack of clarity around exactly how the terms 'used for the manufacture of any product not for human consumption' are to be interpreted. While the term 'not for human consumption' tends to be unambiguous (essentially including anything except food and beverages, which are addressed separately in indents (e) and (f)), two other terms can cause difficulties. Firstly, there are some disagreements as to what constitutes a (finished) product, including whether or not it needs to be in the packaging in which it is sold to the public, or can be moved in bulk. A second issue relates to the term 'used for the manufacture of', and if this means the denatured alcohol has to be used as an ingredient of the final product, or can also be used in a wider sense, e.g. for cleaning the manufacturing equipment.

#### **➤ LACK OF CLARITY REGARDING WHAT CONSTITUTES A PRODUCT**

As noted previously, PDA itself has to be moved under the duty suspension regime, whereas finished products containing PDA are released for consumption. Thus, the question of when alcohol ceases to be classified as PDA, and becomes a finished product, has important practical consequences. Doubts can arise in particular regarding products with a very high alcohol content, such as screen wash or other cleaning products. Several MS reported being aware of cases where shipments in bulk of large quantities of alcohol with only minimal quantities of other ingredients (such as detergent and/or colour) were declared as CN codes other than 2207 – such as 3820 or 3824 – and therefore moved without any controls. National authorities admitted that they could not

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<sup>155</sup> The numbers provided range from 514 to 968 per year for PL (2012-2016), and 118 to 697 for CZ (2014-2016).

be certain of the scale of the problem, since such movements are not registered under EMCS, and detection therefore relies on more or less random checks. Some thought there were only a few isolated cases, but others (especially CZ, PL) believed it could be significant and provide a route for fraudulent activity. In essence, in the absence of a formal definition of what constitutes a finished product, the question is whether and how the national authorities can and are willing to challenge the classification of certain goods they believe are essentially (denatured) alcohol.

The ITEG adopted an opinion in 2014 to clarify that the finished product in which denatured alcohol has been used must be 'a recognisable finished product', and that the products have to be 'held out for sale in their recognisable finished form'<sup>156</sup> (which would include, for example, perfume in a small flacon or screen-wash in a 5 litre retail container, clearly labelled and marketed/sold as such, but not larger volumes of the same products packaged in bulk). The majority of MS voted in favour of this opinion, but a significant minority were opposed, and the different national practices seem to continue. During the interviews, some MS have argued that the packaging does not play an important role in their decision making, but that it is the character of the goods, and the extent to which they have been processed, that should be the determining factor. However, it was also widely recognised that it is very difficult to define clear rules for products as diverse as perfume and screen wash, for example, and that an element of subjectivity remains.

The consequences of this are essentially two-fold. On the one hand, the different interpretations by different MS (and, reportedly, sometimes even different customs offices within a given MS) of what does and does not constitute a finished product leads to legal uncertainty for economic operators, which can have cost implications (in cases where the classification is challenged). A few of the economic operators consulted as part of this study reported having first-hand experience of such situations, but were not able to specify costs, and stated the issue was eventually resolved to their satisfaction (in one case via a BTI). The other potentially negative consequence is an increased risk of fraud from uncontrolled movements of large volumes of 'weakly' denatured alcohol (sometimes mixed with small quantities of other products) declared as something other than PDA. This was raised as a concern by several interviewees, some of whom were able to point to isolated cases of suspicious shipments. For a more in-depth discussion of fraud-related aspects, see the separate Section below.

#### ➤ **INDIRECT USES OF PDA (SUCH AS CLEANING)**

MS diverge on whether or not the term 'used for the manufacture of' means the PDA has to be an ingredient of the finished product, or whether indirect uses, such as cleaning of manufacturing equipment, also qualifies for the exemption. The Commission has previously expressed the view that the use of alcohol for cleaning, disinfection or other adjacent activities does *not* entitle for application of the exemption, and the ITEG opinion referred to above states that the denatured alcohol must have been 'directly' used for the manufacture of that product. However, it seems unlikely that this means the rules are now consistently applied across all MS, and in their responses to the 2015 evaluation questionnaire, the majority of MS expressed the view that PDA used in the production chain, in particular for cleaning, should be exempted. However, others insist that economic operators who want to use alcohol for such purposes should use CDA. Even where PDA is exempted, how this is handled in practice varies – some MS have PDA formulations that are authorised specifically for cleaning purposes (e.g. the UK, where 'any industrial or commercially operated cleaning process' is one of the previously approved uses for one specific PDA formulation called 'industrial denatured alcohol'), others allow companies that have been authorised to use a certain type of PDA as an

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<sup>156</sup> ITEG Opinion 1/2014.

ingredient in a given product to also use the same PDA for cleaning, for example. At least one MS (PL) has revised and clarified its position in recent years, and now consistently exempts PDA for cleaning machinery and similar uses. However, this was only following a court case that ruled cleaning machinery was not to be considered part of the production process as such, and thereby called into question this interpretation. In a broadly similar case – albeit concerning Article 27(1)(d) not (b) – the CJEU also ruled that alcohol used for the cleaning and disinfection of equipment and facilities is to be exempted, *'in so far as that disinfection is inherent in the production process for medicines'*.<sup>157</sup>

Again, the main negative effect of the current situation was described as being legal uncertainty, although none of the interviewees felt the current rules applicable in their respective MS (all of which allowed for an exemption of PDA for indirect uses in some form or other) generated any undue costs or burdens for them. However, where PDA for indirect uses is not exempted, users of denatured alcohol may have to incur additional costs for purchasing and storing CDA in addition to PDA.

**Box 14 – Results from the OPC: experienced issues with PDA (indirect use)**

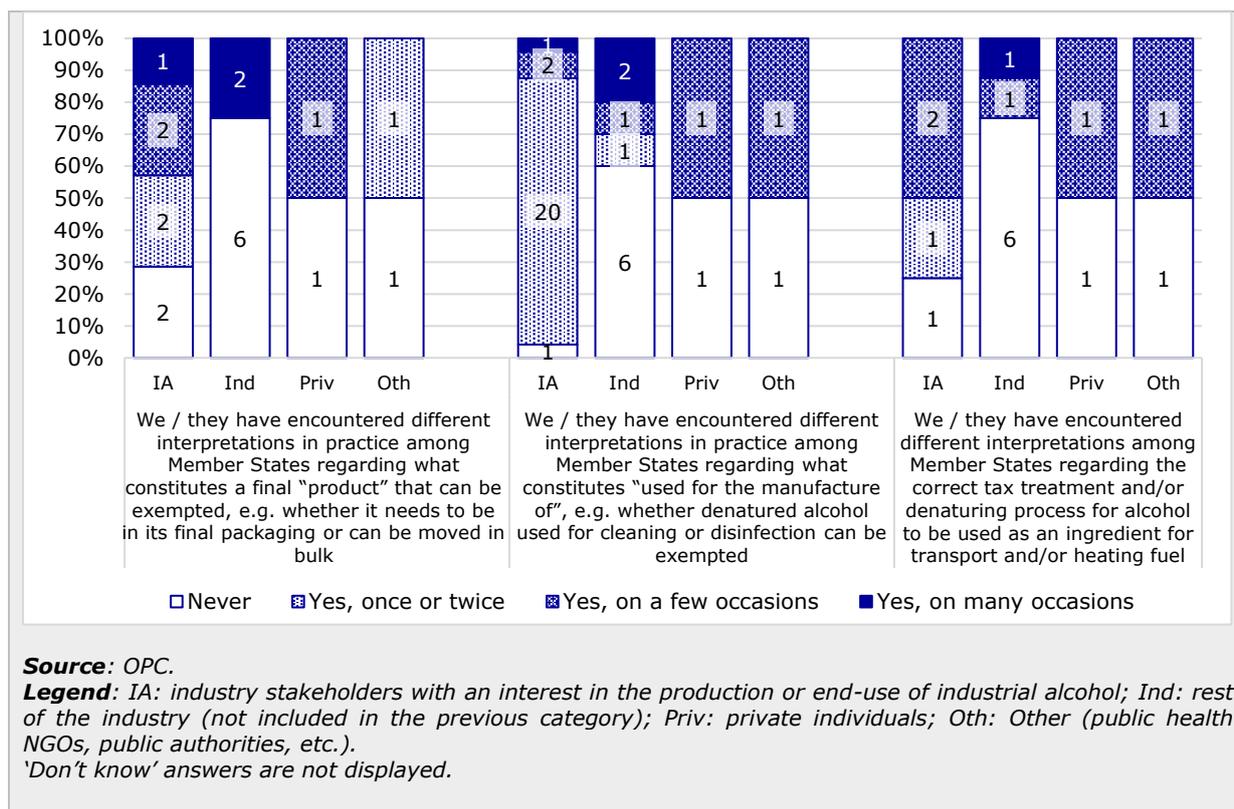
In their responses to the open public consultation:

- 9 respondents (out of 71 who answered this question, including 'don't know' answers not displayed below) indicated they, and/or a company that they had done business or were in direct contact with, had encountered different interpretations in practice among MS regarding what constitutes a final product that can be exempted, e.g. whether it needs to be in its final packaging or can be moved in bulk, on one or more occasions
- 29 respondents (out of 71) indicated they or another company had encountered different interpretations in practice among MS regarding what constitutes 'used for the manufacture of', e.g. whether denatured alcohol used for cleaning or disinfection can be exempted
- 7 respondents (out of 71) indicated they or another company had encountered different interpretations among MS regarding the correct tax treatment and/or denaturing process for alcohol to be used as an ingredient for transport and/or heating fuel

Given the low number of responses to the OPC question on the different possible interpretations of Article 27(1)(b), the majority of stakeholders involved in the production or end-use of industrial alcohol stated that they have encountered issues with different interpretations only once or twice.

**Question #49** - Concerning Article 27(1)(b): Have you, the company you represent, and/or a company that you have done business with or are in direct contact with, ever experienced any of the following issues related to denatured alcohol as regulated by Article 27(1)(b) of the Directive?

<sup>157</sup> CJEU judgment: Bulgarian Customs Agency Director v. Biovet AD (Case C-306/14)



### 2.2.2.4 Fraud risk

Ultimately, the regulatory frameworks for denatured alcohol exist primarily to minimise the risk of fraud, i.e. the diversion of alcohol intended for industrial uses into the potable alcohol market. As such, one of the key considerations is the extent to which this objective is met. Although comprehensive and reliable evidence does not exist, there are strong indications that, in some MS at least, fraud with denatured alcohol is significant.

The WHO has published estimates that around 17% of all alcohol consumed in Europe in 2010 (or about 1.9 litres of pure alcohol per person) was *unrecorded* – that is, alcohol which is not taxed and is outside the usual system of government control, including surrogate alcohol (not intended for human consumption), but also home or informally produced alcohol, smuggled alcohol, or alcohol obtained through cross-border shopping (which is recorded in a different jurisdiction). Among EU MS, the estimated proportion of unrecorded alcohol ranges from as little as 3% (FR, IT) to over 20% (RO, SE).<sup>158</sup> The role of surrogate (i.e. denatured) alcohol<sup>159</sup> within this is also likely to vary significantly. In many MS (including DE, ES, FR), the interviewed stakeholders unanimously agreed that the consumption of surrogate alcohol is almost unheard of, due to a combination of cultural and socioeconomic factors (among them the comparatively low levels of excise duty for alcoholic beverages, including the zero rate on wine, which mean legal alcohol is available cheaply, reducing the incentives for fraud and making the purification of denatured alcohol unattractive economically).

<sup>158</sup> WHO, 'Global status report on alcohol and health', 2014.

<sup>159</sup> Please note that, throughout this report, the term 'surrogate alcohol' is used as a subcategory of unrecorded and illicit alcohol, to refer to the drinking of alcohol that is not intended for human consumption (and therefore exempt from excise duty and usually denatured). This includes both alcoholic beverages (usually fake spirits) that are illegally produced with alcohol from which (some of) the denaturants have been removed or neutralised, and (less commonly) certain products containing alcohol (such as mouthwash, aftershave etc.) that are drunk 'as is' even though they are not (officially) intended or sold for this purpose.

However, stakeholders in other, predominantly Eastern European MS (including CZ, PL) reported that fraud involving surrogate / denatured / industrial alcohol is a significant concern, although they were unable to provide data on the share of surrogate alcohol within the consumption of unrecorded alcohol. In the responses to the 2015 evaluation questionnaire, the highest estimates (from a small minority of MS) were that abuses of the exemptions for denatured alcohol were responsible for 40-80% of the loss of spirits duty from fraud.

**Box 15 - Estimating fraud with surrogate alcohol in Poland**

The WHO estimates the consumption of illicit alcohol in Poland to be about 1.6 litres of pure ethanol, or 13% of total consumption. According to interviewees, the illicit alcohol is predominantly spirits (ethyl alcohol), the total legal consumption of which is about 120 million litres of pure ethanol per year.<sup>160</sup> A project carried out in 2012 by the Polish Spirits Industry in cooperation with the Ministry of Finance found that, between 2009 and 2011, the majority of illicit spirits (7 out of a total of 12 million litres of pure alcohol per year) consumed in Poland were derived from decontaminated / purified industrial alcohol.<sup>161</sup> Based on the current excise duty and exchange rates, this would be equivalent to just under EUR 95 million of excise duty lost per year (or a little under 6% of the total excise duty receipts from ethyl alcohol in Poland).<sup>162</sup> Whether this is considered a realistic estimate depends on who is asked: while the authorities in Poland estimate that the consumption of illicit alcohol has fallen to around 5% of the total in recent years (which, assuming the relative importance of surrogate within illicit alcohol has remained stable, would mean this type of fraud is responsible for around EUR 50 million of lost revenue per year), some industry representatives consider these figures to be too conservative, and reckon the market share of illicit spirits in Poland is closer to 20% (which would bring the total for fraud with surrogate alcohol to almost EUR 200 million per year).

If one applies the 'mid-range' estimates from PL (fraudulent surrogate alcohol consumption of around 6% of the legal spirits consumption; see the box above) to the remaining EU-13 MS, the estimated total excise duty revenue loss is approx. EUR 170 million per year (the largest parts of which correspond to PL, CZ, SK and LT, in this order). This number needs to be taken with a great degree of caution, as it is based on extrapolations from a single study. Nonetheless, it may provide a sense for the likely order of magnitude (rather than the exact size) of the problem in Eastern Europe.

At the same time, one should not assume that the problem does not exist at all in the EU-15. Certain MS (e.g. EL) share some of the same characteristics that favour the occurrence of tax fraud involving industrial alcohol. The high excise duty rates on alcoholic beverages in certain Western and Northern MS also create incentives for this kind of behaviour. Although the main concern in relation to illicit alcohol in these countries is bootlegging and, to a lesser extent, smuggling, there is at least one known recent case in the UK where anti-freeze containing denatured alcohol seems to have been used to manufacture illicit vodka.<sup>163</sup>

The manifestations of the problem are varied. They include purified denatured alcohol (typically from solvents, thinners, barbecue fire-lighters, screen-wash or anti-freeze) from which the smelling and/or tasting agents have been chemically removed, and which is then used for the manufacture of illicit drinks (usually spirits), such as in the examples mentioned above. But there are also reports of cosmetics or personal care products, such as mouth wash or after shave, that can be drunk 'as is' (i.e. without removing the denaturants), and are sometimes sold and bought with this purpose in mind.

<sup>160</sup> Based on total excise duty revenues and rates for 2015 taken from the Commission's excise duty tables.

<sup>161</sup> Cited based on OECD, 'Illicit Trade: Converging Criminal Network. The size, impacts and drivers of illicit trade in alcohol', 2016.

<sup>162</sup> Calculations based on data from the Commission's excise duty tables (2016).

<sup>163</sup> <http://www.bbc.co.uk/news/uk-england-leicestershire-15888342>

Potential ways in which the Directive and/or the way it is implemented at national level may facilitate, or fail to effectively minimise the risk of, this type of fraud, include the following:

- **'Weak' CDA formulations:** The fact that CDA can be sold and bought freely without any controls means it is particularly important the denaturing method used is as robust as possible. There is now broad agreement a robust denaturant should contain three elements – a smelling agent and a tasting agent to make it unpalatable for human consumption, and a chemical analytical marker that is very difficult to remove and thereby allows laboratories to detect fraud. However, some of the national CDA formulations that were in use before 1 August 2017 did not contain all three of these elements. Polish stakeholders reported that in the past, CDA formulations from other MS were used in the majority of fraud cases, in particular those of DE and HU (which lacked a chemical analytical marker such as IPA) and SI (which included IPA and denatonium benzoate but no MEK).
- **A combination of 'weak' PDA formulations and insufficient controls:** As noted previously, in principle the use of less robust formulations for PDA is counterbalanced by the tighter controls regarding its production, movement and use. Nonetheless, in theory at least, shipments of PDA could be diverted to illegal uses during the production process. However, in practice this seems to be very rare, as the authorisation processes, controls, recordkeeping requirements etc. are reportedly strict enough to effectively minimise the risk of this type of fraud in all MS consulted for this study.
- **Finished products containing PDA:** A different matter is that of fraud with finished products that contain PDA and have been released for consumption, especially if the denaturants used are relatively easy to remove. Where these have a high alcohol content, there may be incentives to recover and 'clean up' the alcohol for use in potable products. Certain products can even be drunk directly (see above). The risks are obviously proportionate to the cost of the products in question – for example, many stakeholders tend to agree that the high retail cost of fine fragrances justifies the use of 'weak' denaturants (such as essential oils), as there is no risk of such products being purchased with the intention of drinking them. Others, however, insist on the importance of including at least a chemical marker in all PDA formulations as a matter of principle. In practice, the fraudulent use of products containing 'weak' PDA is reportedly a problem in some MS, albeit not involving high-end products such as fine fragrances.
- **Purposeful misclassification:** A variant of the problem described previously involves alcohol (whether denatured or not) that is classified and shipped as something else (usually under CN codes 3820 or 3824). As with the other types, the exact scale of this is impossible to ascertain due to the lack of data, but anecdotal evidence points to instances where fraudsters may have tried to avoid the controls that usually apply to PDA by claiming they are sending a finished product.

Trying to anticipate future trends regarding fraud with denatured alcohol is inherently difficult. The problem with particularly 'weak' CDA formulations should disappear as the Eurodenaturant replaces the old national formulations in almost all MS; the few remaining national CDA formulations (CZ, EL, FI) are very unlikely to be used fraudulently according to interviewed stakeholders. However, the authorities in some MS (CZ, UK) have expressed concerns the reduced concentrations of MEK and IPA in the 1-1-1 Eurodenaturant are insufficient to effectively minimise the risk of fraudulent use, although analyses coordinated by the JRC and involving all MS' customs laboratories

would seem to suggest otherwise.<sup>164</sup> In any case, if one considers that a system is only as strong as its weakest link (as CDA can circulate freely across the EU, and fraudsters would tend to use the 'weakest' formulation available), then the fact that many MS have replaced their national formulations with the Eurodenaturant would reduce the risk of fraud with CDA overall. Whether this will result in a reduction of fraudulent activity, or in a displacement of fraud towards PDA, is impossible to predict at this stage.

Apart from the lost tax revenue and other negative effects of criminal activity on society, the other main concern in relation to the effects of this kind of fraud is **public health**. Certain denaturants (in particular methanol, which is widely considered the greatest hazard) are toxic, and can lead to illness and even death when consumed – as in the case of the 2012 methanol poisonings in CZ and PL, although, like most cases of methanol poisoning in the last decades, these stemmed from the illegal admixture of methanol rather than from the use of methanol-denatured alcohol.<sup>165</sup> In fact, methanol is no longer widely used as a denaturant in the EU: all CDA formulations containing methanol except one (EL) have been eliminated, and many MS have also acted on the ITEG recommendation that methanol should no longer be used as a denaturant for cosmetics and perfumes.<sup>166</sup> Therefore, the national authorities and stakeholders interviewed for this study were generally not concerned about adverse health effects from ingesting toxic denaturants *as such*. Nonetheless, it was pointed out that there can nonetheless be significant health risks from drinking certain types of surrogate alcohol: for example, screenwash and anti-freeze often contains glycol (as an ingredient rather than a denaturant), which is moderately toxic. Data from the Polish National Health Fund shows an average of around 200 hospital admissions, and around 50 deaths due to glycol poisoning per year in Poland. Another concern are the substances that are sometimes used to *remove* certain denaturants: for example, chloroform has been found in a significant number of samples of illicit samples of alcohol in Poland, apparently as a result of the removal of denatonium benzoate. In addition to these issues, another public health concern is simply the availability of cheap illicit (surrogate) ethanol and the possible effects on consumption.

In this context, it is also worth mentioning **Article 27(5)** of the Directive, which provides a mechanism for MS to raise concerns with CDA or PDA methods that give rise to tax evasion, avoidance or abuse with the Commission, which shall transmit the matter to the other MS and consult the Excise Committee; if the latter disagrees with the measures proposed by the Commission, the matter is to be submitted to the Council. However, the procedure has only been invoked in a handful of cases (most recently in 2016 by LT concerning a PDA formulation authorised in PL, and by PL concerning a CDA formulation notified by HU, respectively). Interviewees noted that the process tends to be cumbersome and time-consuming, and can only be invoked when the origin of the products in question and the denaturants that were used are known.

➤ **SUMMARY OF PROBLEM ANALYSIS**

Problem drivers	Adverse Effects	Expected evolution
<b>Incomplete / inconsistent mutual recognition of CDA</b>	<ul style="list-style-type: none"> <li>• Uncertainty over recognition of national formulations notified by other MS</li> <li>• Operating costs for economic operators in specific circumstances</li> </ul>	<ul style="list-style-type: none"> <li>• The adverse effects are expected to largely disappear when Regulation 2017/1112 applies</li> <li>• A return to non-harmonised national CDA formulations in the foreseeable future is very unlikely, but cannot be ruled out in the longer term under the current rules</li> </ul>

<sup>164</sup> Aries *et al.*, (2016).

<sup>165</sup> Downey, G., 'Advances in Food Authenticity Testing', 2016, p. 577.

<sup>166</sup> ITEG Recommendation 2/2014

Problem drivers	Adverse Effects	Expected evolution
<b>Proliferation of national approaches to PDA</b>	<ul style="list-style-type: none"> <li>• Compliance, administrative and other operating costs for businesses from national rules (not linked to the Directive)</li> <li>• Barriers to intra-EU trade of PDA due to number and complexity of national rules</li> <li>• Competitive advantages for certain sectors in certain MS</li> <li>• Enforcement costs for authorities in certain MS</li> </ul>	<ul style="list-style-type: none"> <li>• No major changes expected</li> <li>• Differences between national approaches will continue to represent challenges for economic operators</li> <li>• Imminent harmonisation of CDA formulations is expected to lead certain sectors in certain MS to switch to PDA</li> </ul>
<b>Divergent interpretation of the terms of Article 27(1)(b)</b>	<ul style="list-style-type: none"> <li>• Uncertainty as to what constitutes a finished product and permitted uses of PDA</li> <li>• Costs for business and authorities from disputes</li> <li>• Fraud risks from intentional misclassification to avoid controls</li> </ul>	<ul style="list-style-type: none"> <li>• No major changes expected</li> </ul>
<b>Fraud risk from ineffective CDA and/or PDA rules</b>	<ul style="list-style-type: none"> <li>• Opportunities for organised crime</li> <li>• Lost tax revenues for MS</li> <li>• Health effects from consumption of surrogate alcohol</li> </ul>	<ul style="list-style-type: none"> <li>• No major changes expected – though wide-spread adoption of the Eurodenaturant is likely to make fraud with CDA more difficult</li> <li>• Fraudsters may therefore shift their attention to PDA</li> </ul>

## 2.3 Reduced rates for small producers

In this Section, the problem definition concerning the provisions on reduced rates for small producers is presented. In Section 2.3.1, first the legal and administrative elements are discussed: the Directive provisions for small breweries and distilleries and their implementation by MS, additional national schemes for small producers, and other forms of excise-related simplifications included in the EU *acquis*. Then, the market analysis for the various relevant products is presented. In Section 2.3.2, the problem analysis is carried out, and the nature and magnitude of the issue at stake, including its likely development, are described. The analysis focuses on the six MS in which fieldwork activities were carried out for this issue: Austria, Belgium, France, Italy, Poland, and the United Kingdom.

### 2.3.1 Baseline assessment

#### 2.3.1.1 The provisions for small breweries and distilleries

Directive 92/83/EEC allows MS to grant reduced excise rates to small producers of beer<sup>167</sup> and ethyl alcohol.<sup>168</sup> Such an exemption cannot be granted to small producers of wine, other fermented beverages, and intermediate products.

MS can reduce rates for small producers of beer and ethyl alcohol up to 50% of the standard rate, subject to two conditions:

- **Yearly output.** The Directive defines what a small producer is in terms of yearly output: up to 200,000 hl of beer for small breweries, and up to 10 hectolitres of pure alcohol (hpa) for small distilleries. MS are free to set lower output thresholds or output brackets corresponding to different rates of reduction.
- **Independence.** A small brewery shall: (i) be legally and economically independent of any other brewery; (ii) use premises physically apart from those of any other brewery; and (iii) not operate under license. A small distillery shall: (i) be legally and economically independent of any other distillery; and (ii) not operate under license.

MS shall apply the reduction to beer or ethyl alcohol manufactured by small producers located within their borders, as well as to the beverages manufactured by small producers located in another MS, on an equivalent basis. Small distilleries, but not small breweries, can also be exempted from tax warehousing arrangements.

#### ➤ IMPLEMENTATION ACROSS MS

The majority of MS – 23 out of 28 – have opted in to the reduced rates for **small breweries**. Thirteen out of these 23 MS have adopted the maximum threshold allowed by the Directive, the remaining 10 a lower one, from as low as 6,000 hl/year in Estonia, up to 150,000 hl/year in Finland. Eleven MS have established a bracket system, with two to five brackets, i.e. they provide a larger discount for very small breweries compared to the one granted to those whose output is close to the threshold. While most of the MS provide for a fixed discount rate (for each bracket where applied) expressed in EUR per hectolitres / degree Plato or EUR per hectolitres / ABV, three MS – Denmark, Poland, and the United Kingdom – have a slightly more complex system where the discount

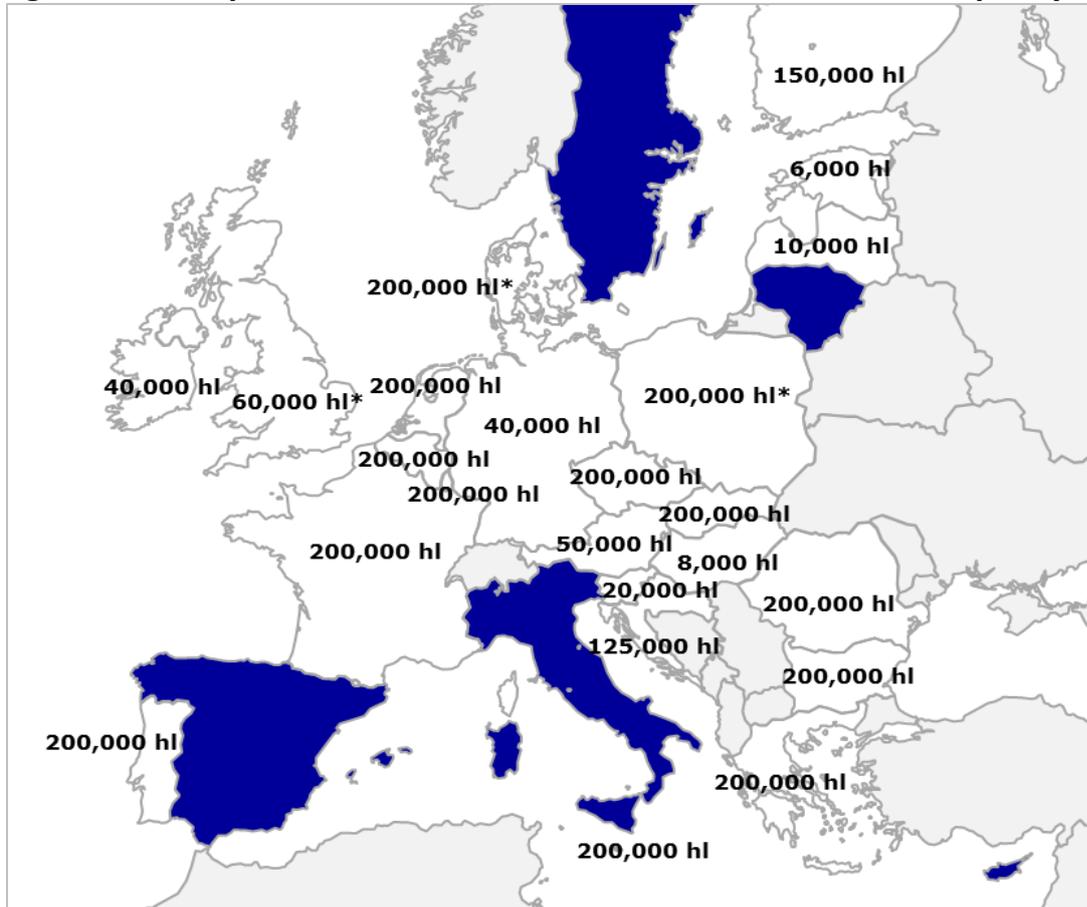
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<sup>167</sup> Article 4 of the Directive.

<sup>168</sup> Article 22 of the Directive.

decreases proportionately as the output increases. Not all MS provide the maximum allowed discount – i.e. 50% of the normal rate – or they provide the full discount only for the smallest output bracket. Information is summarised in Figure 7 below.

**Figure 7 – MS implementation of the reduced rates for small breweries (2017)**



**Source:** EDT.

**Legend:** In blue: MS without reduced rates for small brewers; in white: MS with reduced rates for small brewers and maximum threshold; in grey: non-EU countries. Numbers indicate the threshold applied.

**Note:** (\*): degressive system.

Analysing how MS have implemented this provision, the following considerations emerge:

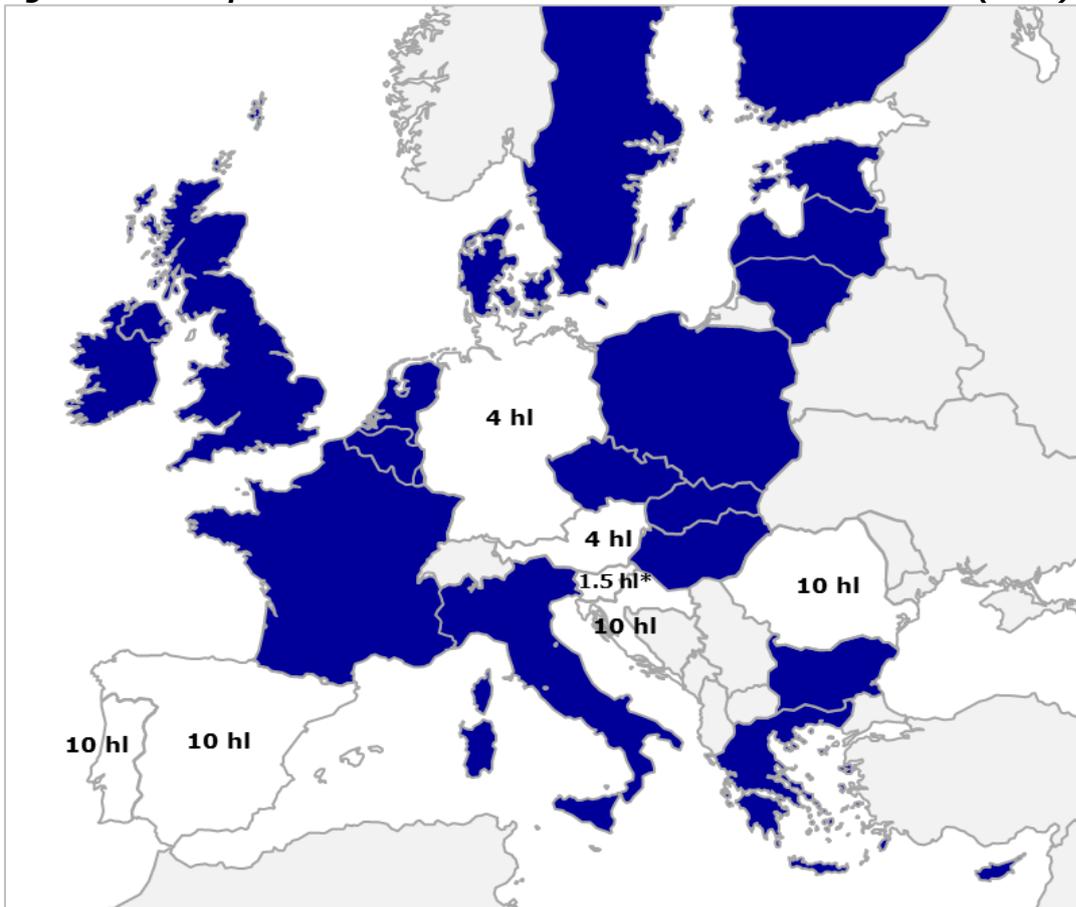
- There does not appear to be an inverse relation between the excise rate level and the decision to grant reduced rates. For instance, Spain and Sweden are among the MS with a higher rate on beer, but they did not opt in to the provision, while low-excise MS such as Bulgaria, Germany, Romania, or Latvia did opt in.
- Smaller MS tend to have lower maximum thresholds, but this is not always the case. For example, small-to-medium MS, such as Belgium, Denmark, Malta, Portugal, or Luxembourg, did adopt the 200,000 hl per year limit, while large MS such as Germany or the UK grant no reduction above 40,000 and 60,000 hl per year, respectively. This results in a very different market share potentially covered by a small brewery, from as low as 0.05% in Germany to as high as 67% in Luxembourg or 92% in Malta.
- A microbrewery producing 1,000 hl per year receives the maximum possible reduction (50%) in 14 MS out of the 23 opting in to the provision, while in 3 MS it receives a limited reduction (less than 15% of the standard rate).
- A small brewery producing 10,000 hl per year is granted the maximum possible reduction (50%) in 10 MS out of the 23 opting in to the provision,

while in 5 MS it enjoys no or limited reduction (less than 15% of the standard rate).

- A medium brewery producing 100,000 hl per year is granted the maximum reduction (50%) in only 5 MS out of the 23 opting in to the provision, while in 12 MS it enjoys no or limited reduction (less than 15% of the standard rate).

Reduced rates for **small distilleries** have a much lower implementation rate, as only 7 MS have decided to apply it: Austria, Germany, Spain, Croatia, Portugal, Romania, and Slovenia. In Slovenia, the yearly output is set at 1.5 hl of spirits per year; in Austria, the yearly output threshold is 4 hlp<sub>a</sub> per year, while, in the other 5 MS, the output threshold corresponds to the maximum allowed by the Directive (10 hlp<sub>a</sub>). All MS provide for the maximum possible discount (50%), except for Austria and Germany, which come close to it (46% and 44% respectively), while in Spain the discount amounts to 12% of the standard rate. There are no output brackets or decreasing reductions. Details are provided in Figure 8 below.

**Figure 8 – MS implementation of the reduced rates for small distilleries (2017)**



**Source:** EDT

**Legend:** In blue: MS without reduced rates for small distilleries; in white: MS with reduced rates for small distilleries and maximum threshold; in grey: non-EU countries. Numbers indicate the threshold applied.

**Note:** (\*): threshold expressed as hl of spirits.

#### ➤ NATIONAL SCHEMES FOR SMALL PRODUCERS OF ALCOHOLIC BEVERAGES

In the six MS visited for this policy issue, two additional schemes providing reduced rates or full exemption to small producers have been identified: the *Abfindung* for small distilleries in Austria and the exemption for small cider makers in the UK.

- **The *Abfindung* scheme for small distilleries in Austria.**<sup>169</sup> In Austria, farmers traditionally distil their own fruit production, for their own consumption as well as for sale. Though its economic importance in terms of farmers' income is considered to be marginal, distillation is regarded as part of the Austrian rural culture. Rules for farmers' distilleries have been in place for more than 250 years. In Austria, two kinds of distilleries may be set up:
  - *Verschlussbrennerei* (sealed distillery), in which the duty to pay is calculated on the exact amount of alcohol produced.
  - *Abfindungsbrennerei* (small-scale flat-rate distillery), in which the excise duty is calculated on an estimated output.

The *Abfindung* regime is defined in Article §55 of the Austrian alcohol tax law<sup>170</sup>. An *Abfindungsbrennerei* can produce up to 2 hlpa per year; on the first hlpa, a reduced rate equal to 54% of the standard rate is applied; on the second hlpa, a reduced rate equal to 90% of the standard rate is applied (§65). Products from an *Abfindungsbrennerei* can be put up for sale under certain restrictions, but cannot be sold in other EU MS (§57). Any individual can apply to carry out distillation activities under the *Abfindung* regime, by registering as a producer and communicating to the customs authority his/her distilling equipment, the raw materials that will be used, and the timing and duration of the distillation. According to the raw materials used and the duration of the distillation, an output is estimated, and the excise duties are calculated. Only own fruit or other agricultural products can be distilled in an *Abfindungsbrennerei*.

- **The small cider maker exemption in the UK.** The United Kingdom has an exemption from excise taxes for small cider makers producing less than 70 hl per year. The exemption dates back to 1976, and was contextual to the introduction of excise duties on cider. The UK government announced in July 2015 that it would retain the exemption 'until and unless a replacement scheme is established'.

To be eligible for the exemption, small cider makers must apply for an authorisation from the customs authority. Once the authorisation is obtained, small cider makers are exempt from the various excise obligations (e.g. recordkeeping, auditing, excise payments, setting up of a tax warehouse). The customs authority performs occasional checks, and further investigates if anything appears suspicious.

#### ➤ OTHER PROVISIONS FOR SMALL PRODUCERS

Though reduced rates are not granted to small producers of wine and other fermented beverages, these may be granted an exemption from most of the administrative requirements provided by the excise legal framework. Article 40 of the Horizontal Directive provides for MS the possibility to exempt small wine producers from the requirements on (i) production, processing and holding (including the setting up of a tax warehouse);<sup>171</sup> (ii) movement of excise goods under suspension;<sup>172</sup> and (iii) any other requirement relating to movement and holding. Small wine producers are defined as those with an output of less than 1,000 hl of wine per year. Based on Article 15 of

<sup>169</sup> A similar scheme exists in Germany as well, as detailed in §114 of Brenno 1998.

<sup>170</sup> 'Bundesgesetz über eine Verbrauchsteuer auf Alkohol und alkoholhaltige Waren (Alkoholsteuergesetz)', consolidated version of 21.04.2017.

<sup>171</sup> Chapter III of the Horizontal Directive.

<sup>172</sup> Chapter IV of the Horizontal Directive.

Directive 92/83/EEC, this provision can also be applied to other fermented beverages.<sup>173</sup> According to the fieldwork carried out and to the recent evaluation of the Horizontal Directive, Austria<sup>174</sup> and Italy<sup>175</sup> apply the exemption; on the contrary, France does not, but it exempts small winegrowers from lodging an excise guarantee.<sup>176</sup>

### 2.3.1.2 Industry analysis

In the following sub-sections, data on the various beverage industries are presented, in order to estimate the number of small players and their market share. For each tax category included in the Directive, the most representative product is analysed: beer, still wine, cider for the other fermented beverages, distilled spirits for ethyl alcohol, and fortified wine for intermediate products. These industries produce the most common products in their category in the six sample MS.<sup>177</sup> Indeed, the supply and market share analysis presented below needs to rely on a relevant market, defined along geographical boundaries (i.e. for each sample MS) and product boundaries. For the definition of the policy options and the impact analysis (in Section 3.3 below), consideration will be given to the extension of reduced rates to the whole tax category.

#### ➤ THE BEER INDUSTRY

Five of the six sample MS apply reduced rates for small brewers. France, Belgium and Poland grant them up to an output of 200,000 hl per year, while Austria and the United Kingdom limit it respectively to 50,000 and 60,000 hl. All MS but France provide for a bracket system, the discount being higher for smaller entities. A reduction up to 50% of the standard rate is granted only by France and the UK, while all other countries provide for a lower discount.<sup>178</sup> Importantly, when breweries get close to the threshold, the reduced rate gets closer to the standard one, at 90% or more of the latter, hence the tax advantage becomes smaller. Full information is reported in Table 29 below.

**Table 29 – Implementation of reduced rates for small brewers in the sample MS**

MS	Standard Rate	Output upper limit (hl)	Brackets (hl)	Reduced rate (% of standard)
AT	2.00 €/hl/° Plato	50,000	0-12,500	60%
			12,500-25,000	70%
			25,000-37,500	80%
			37,500-50,000	90%
BE	2.00 €/hl/° Plato	200,000	0-12,500	87%
			12,500-25,000	90%
			25,000-50,000	93%
			50,000-75,000	96%
FR	7.41 €/hl/% vol	200,000	75,000-200,000	99%
			No as of 2013	50%
PL	1.81 €/hl/° Plato	200,000	0-20,000	68%*
			20,000-70,000	84%*
			70,000-150,000	87%*
			150,000-200,000	90%*

<sup>173</sup> As done e.g. by Italy, see Article 8 of 'Decreto 27 marzo 2001, n. 153, Regolamento recante disposizioni per il controllo della fabbricazione, trasformazione, circolazione e deposito dell'alcole etilico e delle bevande alcoliche, sottoposti al regime delle accise, nonché per l'effettuazione della vigilanza fiscale sugli alcoli metilico, propilico ed isopropilico e sulle materie prime alcoligene', consolidated version of 4.7.2017.

<sup>174</sup> 'Schaumweinsteuergesetz 1995', Part 3, §44 (3).

<sup>175</sup> See Article 37.1 of 'Decreto Legislativo 26 ottobre 1995, n. 504, Testo unico delle disposizioni legislative concernenti le imposte sulla produzione e sui consumi e relative sanzioni penali e amministrative', consolidated version of 4.7.2017. Hereinafter: 'Italian Excise Law'.

<sup>176</sup> Code général des impôts, art. 110-D.

<sup>177</sup> Based on ISWR sales data for 2016 and total excise revenues per fiscal category from EDT.

<sup>178</sup> In Poland, the reduced rate is granted per hl of production, while the excise is calculated per hl/° Plato. Hence, the ratio of the reduced rate over the standard one is not fixed.

MS	Standard Rate	Output upper limit (hl)	Brackets (hl)	Reduced rate (% of standard)
UK**	21.04 €/hl/% vol	60,000	0-5,000	50%
			5,000-30,000	86%***
			30,000-60,000	97%***

**Source:** EDT.

**Notes:** \* calculated on 12° Plato beer; \*\* with reference to beer with 2.8-7.5% vol; \*\*\* calculated on the mid-point of the bracket.

Table 30 below provides a summary of the information retrieved on the production structure of the beer industry in the six MS. These best estimates result from the consolidation of public data provided by tax authorities and trade associations, as well as from quantitative and qualitative information collected during the fieldwork and used to complement missing data. The definition of the various size classes varies from country to country, as there is neither a shared industry consensus, nor a standard data collection format. In most countries, the definition of what a micro or small brewer is depends on the national brackets used to administer the reduced rate scheme. The definition of a medium brewer is largely influenced by the country market structure.

**Table 30 – Number of small brewers and supply structure**

	AT	BE	FR	IT	PL	UK	EU*
% of brewers covered by the reduced rate	90%	97%	99%	0% (98% below 1000 hl)	87%	99%	97%
% of output covered by reduced rate	6%	10%	4%	0%	3%	5%	5%
Market Share							
Micro Brewers (up to 1,000/5,000 hl)	<u>1.5%</u>	<u>3%</u>	<u>1.5%</u>	2.5%	<u>2%</u>	<u>5%</u>	n/a
Small Brewers (up to 10,000/20,000 hl)	<u>8.5%</u>						
Medium Brewers (up to 100,000/200,000 hl)	15%	<u>7%</u>	<u>2.5%</u>	6.5%	<u>8%</u>	20%	
Large Brewers (over 200,000 hl)	75%	90%	96%	92%	90%	75%	

**Source:** *Brewers of Europe: interviews with national trade federations, tax and customs authorities.*

**Note:** ~~market segment covered by the reduced rates; market segment partly covered by the reduced rates.~~

(\*): data refer only to MS implementing the reduced rates; based on values from sample MS (AT, BE, FR, PL, and UK). Size classes are only indicative and vary across the sample MS, depending on the thresholds adopted for reduced rates and industry practice.

Findings show that the vast majority of active brewers, 97% in the overall sample, and about or more than 90% in each country, is covered by the reduced rates. However, their production represents a small share of output, 5% in the overall sample, and not higher than 10% in any MS. In the UK and Austria, where the output threshold is lower than the maximum allowance and where the market features a significant group of so-called regional brewers in the area of 100,000 to 500,000 hl, reduced rates cover 5-6% of the market. In Belgium, a country with a longstanding tradition of local and small brewing and where the maximum threshold is set at 200,000 hl, reduced rates cover 10% of the market, the highest share among the MS analysed. In Poland, there is a significant presence of mid-size breweries, with an output of about 100,000-500,000 hl per year; however, since only a part of these regional players falls below the threshold, the market share covered by reduced rates is about 3%. In France, the importance of small players is limited: even though the number of small brewers increased four-fold over the last decade, their population has grown from a very small base;<sup>179</sup> as a consequence, small

<sup>179</sup> In France, the brewing tradition almost disappeared in the 1980's, when only 30 brewers were active; this was due to changes in consumer taste and the industry consolidation process. This trend has reversed and, nowadays

brewers represent only about 4% of the market. Finally, in Italy, where reduced rates do not exist, microbreweries up to 1,000/1,500 hl represent 98% of the active players and about 2.5% of the market.<sup>180</sup>

#### ➤ THE DISTILLED SPIRIT INDUSTRY

The quality of the information on the number, size, and market share of players active in the supply of distilled spirits is much poorer compared to what is available for beer and wine.<sup>181</sup> This is also due to the fact that only 7 MS opted in for the reduced rates for small distilleries – while 23 opted in for beer – and to the fact that there is no definition of ‘small spirit producer’ in other parts of the EU legislative framework, either for tax or agricultural policies. However, several trends emerged from the fieldwork, which can be summarised as follows:

1. The number of active distilleries is in the order of magnitude of 100 units in four out of the six MS visited: in particular, 120 distillers are licensed in Poland, between 75 and 90 of which are considered active; about 150 are active in Italy, and 230 in the UK. In Belgium, it is estimated that about 40-45 active distilleries are present in the market. In France, the number of operators is estimated at about 5,000-10,000. Austria is an exception: therein, it is estimated that about 30,000-40,000 companies or individuals, mostly farmers, distil spirits – the vast majority under and because of the simplified flat-rate *Abfindung* regime.
2. Data on the size of distilleries are scant. In Poland about 45 distilleries produce less than 100 hlpv per year and their market share is estimated to fall below 0.4%. In France, 50 to 60 distilleries are estimated to fall below 10 hlpv, and they would represent, at maximum, 0.04% of the spirit market. To the contrary, estimates show that about 2,000 French distillers produce less than 10,000 hl of spirits per year (equivalent to 4,000 hlpv at 40% vol). In the UK and Italy, stakeholders and the authorities estimated that the presence of small distilleries with a scale of 10 hlpv is nihil or negligible, and that they could be active only in very premium segments, or as ancillary activities to farming, with a strict local dimension. In Austria on the contrary, most of active distillers fall within the *Abfindung*, and hence produce only up to 1 or 2 hlpv per year.
3. There are growth trends in the small distillery segment, but they are not widespread across the MS. Growth was reported both in the UK, also thanks to a spur of small gin distilleries, and in Belgium, based on data on the applications for a tax warehouse. Growth of small distillation is not driven by fiscal incentives, but rather by consumers’ demand. However, in other countries such as Poland, the number of distillers, and especially of small agricultural distilleries, is rapidly shrinking; in Italy, there is no indication of a growth of small-scale distillation.

#### ➤ THE CIDER INDUSTRY

The consumption of cider is largely concentrated in a handful of MS. The UK has, by far, the largest market, representing about 50-55% of the EU market, followed by Spain, France, Germany, and Ireland.<sup>182</sup> Cider markets are larger in countries where there is a

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about 1,000 active operators exist. E. Gillard, ‘Bières et brasseries françaises du 21ème siècle’, Projet Amertume, 2016.

<sup>180</sup> These findings are in line with those described in the Ramboll Evaluation, where the share of production covered by reduced rates in the three countries for which data are estimated is around or above 90%, and where the 5 big producers control 50% to 70% of the market. MS covered: DE, FR, IT, and UK.

<sup>181</sup> As also acknowledged by trade associations. See Vinum & Spiritus Association Belgium, ‘La réalité économique derrière notre secteur’, Available at: <http://fr.vinumetspiritus.be/sector/economics/de-economische-realiteit-achter-onze-sector/>, last accessed on July 2017.

<sup>182</sup> AICV, ‘European Cider Trends’, 2016 Update.

traditional production. The most important cider-producing countries or regions are indeed the British Islands – both Ireland and the UK – France, especially Normandy and Brittany, Spain, especially the Asturias, and Germany. To better collect information on cider, the sample of MS thus includes Ireland, while Austria and Belgium have been dropped. In this way, the sample consists of three of the largest cider markets (France, Ireland, and the UK) and two marginal producers (Italy and Poland).

Table 31 below provides a summary of the information retrieved on the production structure of the cider industry in these five MS. The estimates below are based on data provided by customs, tax, and agricultural authorities and trade associations. Additional quantitative and qualitative information collected during the fieldwork was used to complement missing data. The definition of the various size classes varies from country to country, as there is neither a shared industry consensus, nor a standard data collection format. In general, micro-cider makers are considered to be those whose yearly production is below 100 hl (e.g. 70 hl in the UK). For these players, cider production remains an ancillary activity, e.g. for farmers or farmhouses. The definition of small cider makers usually encompasses those whose production is below 10,000/15,000 hl.

**Table 31 – Estimated market share of small and micro cider makers and their output**

	FR	IE	IT	PL	UK	EU
% of small cider makers	10%	20%	100%	n/a	32%	15%
% of micro-cider makers	89%	73%		11%	64%	82%
Production share of small cider makers	17.5%	3%	100%	n/a	3%	4.6%
Production share of micro-cider makers	2.5%	0.1%		2%	0.1%	

**Source:** interviews with national trade federations, tax and customs authorities, ministries of agriculture.

**Note:** EU estimates based on the five sample MS.

The distribution of the firm population and production of cider is similar to that of the beer industry. Micro- and small cider makers represent about 97% of the number of active companies, and between 93% and 99% in the MS considered. Their production share is estimated at 4.6% in the MS considered, and is below 5% in all countries except for France, where small independent companies are estimated to represent between 15% and 20% of the production. The production of micro-cider makers is negligible in the UK and Ireland, where the market is dominated by very large companies, and does not reach more than 3% in Poland and France, confirming the ‘ancillary’ nature of this market segment.

### ➤ THE STILL WINE INDUSTRY

The still wine value chain features different actors that play different roles in terms of scope of the activity. There are at least four kinds of wine producers:

1. ‘Classical’ wine makers: companies that are both wine growers and wine makers; they produce and bottle their own wines. A wine maker may also buy grape, juice or bulk wine from other producers, in a variable percentage.
2. Independent wine makers: as the classical wine maker, they are both wine growers and wine makers. However, independent wine makers process only their own grape. They usually have a smaller scale than classical wine makers.
3. Cooperatives of wine growers: a cooperative collects grape, juice or bulk wine from its members, which in turn usually are co-owners, who then receive monetary or in-kind compensation as a share of profits or finished production. Cooperatives are thus wine makers, but not necessarily wine growers. Very small wine growers, who

have no interest or no means to produce, bottle, and trade wine, usually confer their production to cooperatives.

4. *Negociants en vin*, or wine shippers: a wine shipper buys grape, juice, or bulk wine from wine growers, and then produces, bottles and sells wine under its own name. Hybrid companies exist, which are wine makers and also produce wine as shippers.

As a consequence, there could be at least two kinds of small players in the still wine value chain: the small wine grower – regardless of whether it confers his/her production to a large player or not – and the small wine producer. As the focus of the reduced rate provisions is on operators producing alcoholic beverages (i.e. breweries and distilleries), rather than on other operators along the value chain, the analysis below focuses on small wine producers. However, it should be remembered that large wine makers often work in cooperation with a constellation of small players.

Table 32 below provides information on the share of players below 1,000 hl in the six sample MS, and on their share of national production. Data on firm distribution have been collected from public authorities, trade associations, and sectoral literature.<sup>183</sup> In countries where the production of wine is marginal (Belgium, Poland, and the UK), all producers are considered to fall below this threshold. In Austria and Italy, the vast majority of producers has an output lower than 1,000 hl; however, in Austria, where production is very much atomised and there are very few large winemakers, small producers represent about 57% of the national production; in Italy, where large producers do exist, small producers only represent about 15% of national production. The only country where the number of small producers is lower than 90% is France, with 69% of wine producers estimated to be small; in terms of production, their share is in line with that of Italy (17%).

**Table 32 – Estimated market share of small still wine producers and their output**

	AT	BE	FR	IT	PL	UK	EU
% of wine producers below 1,000 hl	97%	100%	69%	92%	100%	100%	85%
% of production	57%	100%	17%	15%	100%	100%	17%
Total wine production 2015-16 ('000 hl)	2,300	10	47,900	51,500	4.5	40	165,600

**Source:** DG AGRI, AGRIMER; interviews with national trade associations, CEVI, ministries of agriculture, tax and customs authorities.

**Note:** EU estimates based on the six sample MS.

### ➤ THE FORTIFIED WINE INDUSTRY

Intermediate products are a residual category – hence, ‘intermediate’ between fermented beverages and ethyl alcohol, which includes products ‘typically based on a naturally fermented beverage to which alcohol and, in some cases, other ingredients have been added’.<sup>184</sup> Its residual character is confirmed by the fact that it represents the least significant category in terms of tax revenues: at EU level,<sup>185</sup> revenues from intermediate products amount to 2.3% of total excise revenues, with the maximum share in Portugal – home of Port wines – where it reaches 6.3%.

<sup>183</sup> For France, data refer to wine producers below EUR 10 mn of annual revenues. A company of this size would produce less than 1,000 hl, with the exception of players producing the cheapest category of wine, i.e. without any geographical indication. Even in this case, considering 2015 prices, a company would produce about 1,250 hl. Hence, this revenue threshold is considered a good approximation of the 1,000 hl output threshold. For the UK, the share of producers below 1,000 hl is estimated based on qualitative information.

<sup>184</sup> Commission of the European Communities, Proposal on the harmonisation of the structures of excise duties on alcoholic beverages and on the alcohol contained in other products, COM(90)432, 7.11.1990, at p.8.

<sup>185</sup> Excluding 5 MS for which disaggregated revenues from intermediate products are not available: EL, HR, IT, MT, and PL.

This category includes several products, such as fortified wines, *vin doux naturel*, vermouth, aromatised wine aperitifs, as well as certain mixed drinks with a fermented base. As a homogeneous analysis of such a diversified range of products is not possible, the focus will be on fortified wines, the most representative product in this category.<sup>186</sup>

Fortified wines are produced by adding alcohol – usually by means of a neutral strong spirit – during fermentation to increase the alcoholic strength of the product. As a result, fermentation is stopped, so that a part of the sugar content of the must is not converted into alcohol, and the resulting product has a sweeter taste.<sup>187</sup> Port, Sherry, Madeira, Marsala, Samos and Pineau des Charentes are among the most common types of fortified wines. All these products have geographically protected indications. The quantity of fortified wines is limited when confronted to wine. As an example, the production of Port amounts to about 650,000 hl,<sup>188</sup> the volume of Sherry is about 900,000 hl,<sup>189</sup> in Italy about 25,000 hl of Marsala and 30,000 hl of other fortified wines are produced,<sup>190</sup> and finally about 33,000 hl of Madeira are produced each year.<sup>191</sup>

The value chain for fortified wines include growers, producers of the base wine, and 'fortifiers'. Grapes and base wine can be produced by a large number of wine growers: for example, 30,000 for Port,<sup>192</sup> and 1,050 for Madeira. However, the vast majority of them does not produce the end product: fortification and ageing (where necessary) are done by shippers (also *Bodegas* for Sherry). For instance, 90% of the Port trade is concentrated on 15 shipping houses,<sup>193</sup> while there are 7 producers of Madeira,<sup>194</sup> and about 60 shippers / stockists / *Bodegas* for Sherry.<sup>195</sup> The estimated average production for these producers is 39,000 hl for Port, 47,000 hl for Madeira, and 15,000 hl for Sherry. For this reason, although many small wine growers or wine makers work within the value chain, the number of small producers and their market share is residual.

### 2.3.2 Problem analysis

The Commission Report considers that the existing rules on reduced rates are working well and the Council shares this view.<sup>196</sup> However, a baseline analysis concerning the application of the reduced rates to small breweries and small distilleries needs to be carried out, in order to verify whether a problem exists, and, where appropriate, to quantify its magnitude. Indeed, the OPC and the stakeholders suggested that in some areas problems with the application of current norms occur; these problems are discussed in Sections 2.3.2.1 for small brewers, and 2.3.2.2 for small distillers.

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<sup>186</sup> The share of revenues from fortified wines over the total revenues from intermediate products at EU level is of 61% (sales data retrieved from IWSR, excise duty rates and revenues from EDT). The analysis excludes MT, EL, IT, PL, HR, IE and UK, because revenue data on intermediate products are not homogeneous. Outliers (NL, ES) adjusted based on EU average.

<sup>187</sup> Court of Master Sommeliers, 'Port – Port Trade', Available at: [www.courtofmastersommeliers.org/pdfresources/portnotes.pdf](http://www.courtofmastersommeliers.org/pdfresources/portnotes.pdf), last accessed on July 2017.

<sup>188</sup> Correia L., Rebelo J., Caldas J., 'Production and Trade of Port Wine: Temporal Dynamics and Pricing', Page 16 (2012 data), 2015.

<sup>189</sup> Great Wines from Spain, 'The Wines – Sherry', Available at: <http://www.greatwinesfromspain.com/the-wines/sherry>, 2014 Data, last accessed on July 2017.

<sup>190</sup> Corriere Vinicolo, 2016 data.

<sup>191</sup> Wijnstudio, 'Madeira Wine', Available at: <http://www.madeirawine.nl/madeira-wine/>, last accessed on July 2017.

<sup>192</sup> Brito C, 'A network perspective of the port wine sector', International Journal of Wine, Vol. 18 No. 2, 2006.

<sup>193</sup> The 15 members (shippers) of AEVP represent 90% of the total Port trade, Available at: <http://www.aevp.pt/Members>, last accessed on July 2017.

<sup>194</sup> Discovering Madeira, 'Who produces Madeira Wine', Available at: <http://www.discoveringmadeira.com/who-produces-madeira-wine>, last accessed on July 2017.

<sup>195</sup> Consejo Regulador de los Vinos de Jerez y Manzanilla, 'Bodega Types', Available at: <http://www.sherry.wine/wines/bodegas>, last accessed on July 2017.

<sup>196</sup> Council Conclusions (2016), at §8.

The IIA identifies a specific problem at stake for this policy issue: the risk of unequal treatment in so far as reduced rates are available for beer and ethyl alcohol, but not for wine, other fermented beverages, and intermediate products.<sup>197</sup> Accordingly, the Council has invited the Commission 'to investigate the impacts of extending those rules to other categories of products.'<sup>198</sup> This issue is dealt with in Section 2.3.2.3 below.

### 2.3.2.1 Functioning of the reduced rates for small breweries

#### ➤ DOMESTIC FUNCTIONING

The analysis reported below considers three aspects of the application of the provisions for small brewers: (i) whether the output threshold (200,000 hl per year) is appropriate; (ii) whether the system generates unnecessary administrative burdens for economic operators or enforcement costs for public authorities; (iii) whether the provision, and in particular the conditions defining an independent brewer, scores well in terms of legal certainty.

With respect to the **current threshold**, it is considered appropriate because it allows MS to support SME in overcoming diseconomies of scale and the costs of market access barriers in a sector where most of the market is concentrated on a limited number of very big players.<sup>199</sup> The threshold is sufficiently high to allow MS to include micro and small breweries, as well as medium and regional players (at least the smallest among them).

MS authorities were keen on retaining the current limit and its flexibility,<sup>200</sup> and did use a lower threshold (e.g. in Austria and the UK) to tailor the effects of the reduction according to their national market structure. Few economic operators expressed discontent with the current threshold, and this is also confirmed by the OPC results, where 61% of respondents from the beer industry consider it appropriate. Negative reactions were collected during the fieldwork, because of the specificities of national market structures. In some countries, such as the UK, the 200,000 hl threshold would artificially dichotomise the population of regional breweries in the area of 100,000 hl to 500,000 hl, and this might create market distortions. Mid-size players are also present in Austria (where stakeholders insist that the government should raise the national limit), Belgium, and Poland. The problem is, however, largely theoretical: in Austria and the UK, the governments set the limit much below, at 50,000 hl and 60,000 hl respectively; in Poland and Belgium, where the maximum threshold is adopted, the discount is lower the larger the firm output, and gets quickly close to 0%.<sup>201</sup> This further demonstrates that the current provision, including the threshold, allows MS to tailor this provision to national specificities.

During the fieldwork, a group of economic operators complained that the threshold, by its nature, discourages the growth of small brewers. Indeed, when a small brewer has a yearly production very close to the national threshold, increasing its scale could be unprofitable because of the loss of access to the reduced rates. In practice, this problem affects only MS which (i) do not have any brackets or a degressive system; and (ii) provide for a significant discount. This is e.g. the case of France, where a 50% discount is granted up to 200,000 hl. However, in France the number of breweries in the 10,000-200,000 hl is very limited (about 10), hence the risk appears theoretical. To the contrary, in Belgium, Austria, Poland, and the UK, the brackets or degressive systems in place reduce the disincentive to grow, because brewers 'at the edge' of the threshold already

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<sup>197</sup> IIA (2017), at p.2.

<sup>198</sup> Council Conclusions (2016), at §8.

<sup>199</sup> See Section 2.3.1.2 above.

<sup>200</sup> In line with the findings of the Commission Evaluation, where it is reported that only two Member States expressed discontent with the available limit.

<sup>201</sup> In PL, the discount amounts to 13% of the standard rate for breweries above 70,000 hl, and to 10% for those above 150,000 hl (assuming a beer with 12° Plato). In BE, the discount is of 4% above 50,000 hl, and of 1% above 75,000 hl.

receive a small advantage. In theory, one could consider providing the reduced rates on the first 200,000 hl brewed by any player, regardless of its size. This mechanism would remove any disincentive to grow. However, the implementation of this system would prove difficult for at least two reasons: (i) beer is taxed based on hl per ABV or degree Plato, hence it would be necessary to determine the strength of the first 200,000 hl, and companies could abuse this provision by brewing strong beer first; (ii) excises are paid not only directly by breweries, but also by domestic or international distributors, and reconstructing where the first 200,000 hl of production has ended up would be complex.

In terms of **administrative burden** for economic operators and **enforcement costs** for public authorities, the fieldwork confirmed that the reduced rates for small brewers do not require unnecessary efforts, from neither companies nor customs. Enforcement costs with respect to domestic producers were considered to be minimal by all tax and customs authorities interviewed. In the word of one customs officer, 'costs or burdens for public authorities are not an issue for the scheme'.

Economic operators across the 6 MS visited largely concurred on the very limited administrative costs generated by the reduced rate schemes. The Fiscalis discussion document on reduced rates<sup>202</sup> also confirms that burdens and formalities for small breweries often arise from the compliance with the overall excise provisions, and in particular the requirement to set up a tax warehouse and provide a guarantee, rather than from the reduced rate schemes.<sup>203</sup>

To estimate administrative burdens, a deep dive survey of small economic operators was carried out with the support of national trade associations in 3 MS implementing reduced rates. Five operators were surveyed by means of a written questionnaire in the UK, and four operators were interviewed in France and Poland to this purpose. In these countries, procedures to obtain or demonstrate the status of small producer are quite similar.<sup>204</sup> The information obligations to which the small brewer is subject can be described as follows:

- Submit a declaration on the quantity produced during the previous year (in Poland and France) or on forecasted production for the current year (UK). For declarations concerning previous year production, the necessary information can be extracted from the records already kept under the excise legislation, so that the cost is minimal (filing an additional form). For declarations concerning the current year, a forecast needs to be prepared by the small brewer. However, UK operators consider this obligation requires a negligible amount of time.
- Prove the status of 'independent brewery'. In the UK, this is done by means of a self-declaration; in France, this consists in a one-off submission of a set of company documents (e.g. copy of the company register, information on shareholding, company charter).
- Specify the status of 'produced by an independent small brewery' in the ECMS movements.<sup>205</sup> This can be done by flagging the appropriate parameter in the system, and comes at negligible costs.

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<sup>202</sup> Fiscalis discussion document, at p.5.

<sup>203</sup> MS can already allow small brewers to release for consumption their products upon production, and therefore exempt many of the formalities related to the tax warehouse. This is the case of e.g. Italy, where small brewers up to 10,000 hl can opt for a simplified regime for duty payment. See Agenzia delle Dogane e dei Monopoli, 'Circolare 5/C, Determinazione direttoriale prot.140839 del 4 dicembre 2013, concernente l'assetto del deposito fiscale e le modalità di accertamento, contabilizzazione e controllo della produzione per i microbirrifici', 06.05.2014.

<sup>204</sup> See HM Revenues and Customs, 'Excise Notice 226: Beer Duty', at §8; Bulletin officiel des douanes, 'Contributions Indirectes, Régime Fiscal Des Boissons Alcooliques, Droit Spécifique Sur Les Bières Taux Réduits Pour Les Bières Produites Par Les Petites Brasseries Indépendantes for France'.

<sup>205</sup> See Annex I to the Commission Regulation (EC) No 684/2009 implementing Council Directive 2008/118/EC as regards the computerised procedures for the movement of excise goods under suspension of excise duty.

- Negligible additional costs related to inspection and controls are reported, as records of the quantity produced by each brewer are already kept and verified under normal customs procedures.

Based on the replies from small operators, a typical firm is assumed to spend about 1 hour clerk's work per month to comply with the requirements described above, i.e. 12 hours per year. The Business-As-Usual factor is estimated at 25%, given that keeping track of past, current, and future production levels is a part of 'typical company' activity.<sup>206</sup> Annual burdens<sup>207</sup> per company – monetised based on the salary of a clerk, including overheads<sup>208</sup> – in the 5 MS applying reduced rates for the beer sector vary from about EUR 60 in Poland to EUR 280 in Austria, with a sample average of EUR 178. Total burdens in the 5 MS amount to EUR 600,000. Given the volumes of production subject to reduced rates,<sup>209</sup> administrative burdens amount to about EUR 0.09/hl of beer. Extrapolating the analysis to the whole EU – namely, to the 23 countries adopting the reduced rates for small brewers – based on national production, total burdens amount to about EUR 1.5 mn. Administrative costs and burdens are summarised in Table 33 below.

**Table 33 – Administrative costs and burdens due to the reduced rates for small brewers**

MS	Unit admin costs	Unit admin burdens	Total admin burdens	Admin burdens
	Euro		€ '000	€/hl
AT	372	279	55	0.10
BE	352	264	52	0.03
FR	258	194	196	0.24
PL	78	59	8	0.01
UK	211	158	290	0.13
Sample MS	-	-	601	<b>0.09</b>
<b>EU28</b>	-	-	<b>1,517</b>	

**Source:** Author's elaboration based on a survey of small operators.

With respect to **legal certainty**, the main issue is the definition of the conditions at which a brewer is given the status of 'independence'. The granting of reduced rates to small producers is conditional upon their independence in legal and economic terms. However, independence in legal and economic terms is not further defined in the Directive, and, as confirmed by stakeholders, the exact implementation of this legal concept may lead to uncertainty in some MS.

In most cases, the condition of legal and economic independence does not generate legal uncertainty, as other areas of the EU law can be resorted to. For example, the Commission Recommendation on the definition of SME<sup>210</sup> provides an explanation of when two companies shall be considered as partners or linked, based on capital or voting rights, or on sharing people having a decisive influence over company key decisions (e.g. appointment of the board).<sup>211</sup> However, two grey areas may remain: when the small producer is the licensee of another producer, and when the small producer outsources part of its production to another brewer.

<sup>206</sup> The Business-As-Usual factor measures the share of administrative costs that a company would incur even though there was no regulation in place. In a nutshell, it captures the activities which are part of the normal business administration (in this case, keeping track of production levels). Administrative burdens – i.e. those strictly generated by a norm – are defined as the difference between administrative costs and Business-As-Usual costs.

<sup>207</sup> The BAU factor is assumed at 0%.

<sup>208</sup> Source: Eurostat Earning Structure.

<sup>209</sup> See Section 2.3.1.2 above.

<sup>210</sup> Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, C(2003)1422, 6.5.2003.

<sup>211</sup> The matter was also clarified by the CJEU in 2009. See Judgment of the Court of 2.04.2009, 'Glückauf Brauerei GmbH v Hauptzollamt Erfurt', C-83/08.

With respect to beer brewed under license, i.e. beer produced by a small producer on behalf of another brewer and under the trademark of the latter, the issue has largely been settled by existing guidelines and clarifications. Though details are not provided by the Directive, the Minute Statements from the ECOFIN Council meeting adopting the Directive express the following rules:

- beer produced under license is not eligible for the reduced rate;
- a small brewer can brew under license without losing his/her right to the reduced rate on the rest of his/her production, provided that (i) beer under license represents 'a minority' of the total production; (ii) total production, including beer under license, remains within the maximum threshold.<sup>212</sup>

In the context of a Fiscalis group, issues have been reported by MS with the identification of a license contract, as opposed to any contract (e.g. purchase or outsourcing) providing for Company A to brew beer for Company B. The key factor is considered to be the transfer of the right to use the trademark of another company.<sup>213</sup> The condition of 'brewing under license' was also recently interpreted by the CJEU, which confirmed that the transfer of trademark and know-how identifies a license contract.<sup>214</sup> Stakeholders have not reported significant problems with the implementation of the 'brewing under license' condition, and national frameworks and interpretations largely conform to the rules detailed above.<sup>215</sup>

The second grey area concerns 'contract brewing'. In this case, a small producer outsources, possibly under license, the production of beer to another brewer. This business relation is less common than that of a small producer brewing under license, but it may arise, e.g. when the small brewer has exhausted its production capacity. The first question is whether contract brewing is likely to be used to circumvent the output threshold, either because of the associated legal uncertainty or the lack of appropriate verification by customs authorities. The second question is whether contracted beer can be taxed at a reduced rate or should be treated like beer brewed under license, and thus excluded from the reduced rate. The third question is whether this contract breaches the independence of each counterpart or not and, if not, whether each of the two operators individually or the two operators jointly should remain below the output threshold in order to continue benefiting from reduced rates.<sup>216</sup> Such a problem was mentioned by UK operators, and it was confirmed that this area may still have a certain degree of subjectivity. French stakeholders reported that this issue should have been settled by a Customs Memorandum, but that, despite the intentions, this has led to different interpretations by local customs offices. In Austria, the law provides that when two breweries are 'dependent from each other', such under certain types of cooperation, their total production should be considered in order to verify whether they meet the threshold for reduced rates.<sup>217</sup>

In conclusion, the baseline assessment of the clarity of the current provision is positive, so that, in most cases, its implementation does not engender legal uncertainty or costs. However, grey areas remain, which, although not concerning the vast majority of small brewers, affect the legal certainty for economic operators having entered into certain cooperation agreements, in particular contract brewing. In these areas, the uncertainty has given rise to disputes, and thus to litigation costs, as well as to other costs related to the determination of the status of economic independence. This is also confirmed by the

<sup>212</sup> See 'Fiscalis Discussion document', at p.5.

<sup>213</sup> Ibid., p.6.

<sup>214</sup> Judgement of the Court of 4.6.2015, 'Directeur général des douanes et droits indirects and Directeur régional des douanes et droits indirects d'Auvergne v Brasserie Bouquet SA', C-285/14.

<sup>215</sup> See the UK and FR guidance documents mentioned above (HMRC, 'Excise Notice 226: Beer Duty'; Bulletin officiel des douanes, 'Contributions Indirectes, Régime Fiscal Des Boissons Alcooliques, Droit Spécifique Sur Les Bières Taux Réduits Pour Les Bières Produites Par Les Petites Brasseries Indépendantes for France').

<sup>216</sup> A legal case is undergoing before a French court (interviews with economic operators).

<sup>217</sup> See 'Biersteuergesetz 1995', at §3.6.

replies to the OPC: whereas only one third of respondents from the beer industry considered the application of reduced rates to operators from other EU MS or third countries a moderate or major issue, the share increased to 81% with respect to the definition of independent operator.

➤ **CROSS-BORDER FUNCTIONING**

As reduced rates for small brewers are optional, companies in different MS may be put in a different competitive position. To prevent unfair treatment of non-national producers, and since excises are paid based on the rates and conditions of the MS in which goods are released for consumption, the Directive mandates that imported beer manufactured by small producers established in another MS shall also be granted the exemption, on an equal footing (thus complying with Article 110 of the Treaty on the Functioning of the European Union (TFEU)).<sup>218</sup> In addition, the WTO principle of national treatment – i.e. that the same tax rate should be applied equally to domestic and third-country producers – should also be complied with. As a consequence, the reduced rate should be extended to any small brewer, be it domestic, from another MS, or from a third-country.<sup>219</sup>

Although no issue of legal uncertainty and clarity arises, there can be implementation problems, as customs authorities in the country where the product is released for consumption need to check the status of the brewer. The information collected from tax authorities and economic operators is mixed in this sense. Tax and customs authorities agree that the framework is clear and that foreign operators, both from other MS and third-countries, should be granted the same treatment; however, they disagree on how to prove the status of small producer. Certain authorities consider this to be a 'self-declaration' scheme, so that controls on intra-EU traders claiming the status of 'small producer' are done only in case something suspicious is detected. In this case, the customs authority in the MS of destination may submit a request for information to the customs authority in the MS of origin in order to verify the status.<sup>220</sup> However, most of the customs authorities interviewed do require a certificate from the brewers or their distributors, issued or stamped by the home country customs authorities. Economic operators interviewed confirmed that, when moving products to another MS, the local distributor may ask for such a certificate, but this does not happen in every MS of destination. A problem arises when (i) a small brewer established in a MS not requiring the certificate and not issuing the certificate to domestic manufacturers intends to enter the market of a MS requiring such a certificate; (ii) or when the MS of destination does not automatically recognise the status granted by the MS of origin.<sup>221</sup> Hence, there appear to be only minor disturbances to the functioning of the Single Market for small brewers, mostly connected to specific trade flows, or to international trade. The limited scale of the phenomenon is also confirmed by the OPC, where only one third of the respondents from the beer industry considered cross-border aspects of reduced rates to be a moderate or major issue.

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<sup>218</sup> In Article 4.3.

<sup>219</sup> The uneven treatment of domestic and third-country producers of alcoholic beverage was the subject of a WTO dispute between EU and Canada. The case was settled by mutual agreement so that Canadian import tariffs on alcoholic beverages were reduced in order to offset the tax advantage for domestic producers. See WTO, 'DS354: Canada – Tax Exemptions and Reductions for Wine and Beer'.

<sup>220</sup> Checking the status of operators based in a third country may be more difficult. However, no problems were reported with major trade partners, such as Canada and the US. Importantly, the number of small brewers originating from non-EU MS is very limited, given the investment necessary to enter a distant market.

<sup>221</sup> Only in two MS this problem is mentioned as affecting a significant number of operators; it relates to sales of beer produced by Belgian small producers in France. France allegedly does not accept self-certification and does not always recognise checks performed by the Belgian customs authority.

➤ **OTHER ASPECTS**

To complete the analysis of the baseline situation, the following categories of effects are to be analysed:

- **SME competitiveness.** The issue of SME competitiveness can be analysed from two perspectives: static, i.e. whether current players enjoy benefits because of the reduced rates, and dynamic, i.e. whether reduced rates favour the entry of new micro and small companies in the beer industry.
  - **Static competitiveness.** During the fieldwork, economic operators were asked whether reduced rates supported SME competitiveness, e.g. by increasing profits or investments, or whether they were largely appropriated by distributors or passed-on to consumers. Economic operators consider that the provision supports the competitiveness of small brewers, and that the tax discount does benefit small operators, rather than being passed through the value chain. Hence, the provision is effective in counterbalancing lower costs enjoyed by large companies, in particular because of economies of scale and market access barriers. The limited pass-on is also consistent with the fact that small brewers are most likely to produce craft beer, as opposed to the mass products mostly marketed by large companies. As a consequence, price levels are different, and this reduces the incentive to pass-on the tax discount in order to remain competitive vis-à-vis larger players. Further empirical evidence is provided by an industry study on British small brewers, where most of the respondents indicated that the excise reduction was kept within the firm (e.g. for investment), and only 12% indicated that it led to a price reduction.<sup>222</sup> In line with the findings from the fieldwork, all small brewers taking part to the OPC expressed a very positive assessment of the reduced rates provisions.
  - **Dynamic competitiveness.** While reduced rates have a clear positive impact on SME competitiveness, their effect on the entry rates in the beer industry is not univocal. There seems to be a trend towards the growth of the micro and small brewery segment, which is, however, according to economic operators' view, largely driven by market demand. This trend is even across countries, regardless of whether they have implemented the reduced rates or not. In France and the UK, where the discount for microbreweries is also significant (50% of the standard rate), their number has more than doubled over the 2010-2015 period (annual growth rate of respectively 16% and 19%). In Austria, the number of microbreweries remained stable (+13% over 5 years); however, the discount for microbreweries in this country is significant (40% of the standard rate). In a different context, in Italy, where there are no reduced rates, the number of microbreweries almost doubled in the 2010-2015 period<sup>223</sup> (annual growth rate of 13%).<sup>224</sup> While operators consider that reduced rates support the entry of new players, these data suggest that the provision of reduced rates is neither a necessary nor a sufficient condition, and that other national factors are also at play (such as consumer demand, as well as industry structure, market stability, type of beer consumed by the population, competition from other beverages).
- **Foregone excise duty revenues.** All customs authorities interviewed considered that the reduced rate schemes did not generate large costs for the public budget.

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<sup>222</sup> SIBA, 'British Beer: The Report on the 2017 Members' Survey of the Society of Independent Brewers', 2017.

<sup>223</sup> The operationalisation of the simplified excise regime for microbreweries in 2014 did not increase the trend.

<sup>224</sup> The same is valid for another MS out of the sample, Spain, which does not have reduced rates for small brewers. Therein, albeit from a very small base (46 microbrewers in 2010), the number of microbreweries increased nine-fold over the 2010-2015 period.

As shown in Table 34 below, in the visited MS, the costs of these schemes are between 0.5% and 1.5% of excise revenues from beer. The amount of foregone revenues depends on multiple factors, namely (i) the market share covered by reduced rate; (ii) the size of the discount; (iii) the absolute level of the excise for beer; (iv) the average beer strength.<sup>225</sup> Estimated costs vary from about 1 million EUR in Belgium, where the discount granted to small breweries is limited to 1-13% of the standard rate, to more than EUR 60 mn in the UK, mostly because of the relatively high standard rate (Table 34).

**Table 34 – Amount of foregone excise duty revenues due to reduced rates**

MS	Foregone revenues	As a % of tax revenues from beer
	€ '000	
AT	2,000*	1.1%
BE	1,000**	0.5%
FR	15,000**	1.8%
PL	4,000**	0.5%
UK	60,354*	1.4%

**Source:** Author's elaboration of information provided by tax authorities and trade associations.

**Note:** \* for AT and the UK, data were provided by the Ministries of Finance; \*\* for BE, FR, and PL estimates are based on the market share covered by the reduced rates (rounded to the nearest mn).

- Market effects: intra-market distortions.** The Commission Report states that '[b]ased on the analysis of competition, it seems unlikely that the presence of reduced rates for small brewers [...] have caused any negative competitive distortions within their markets[.]'<sup>226</sup> This finding is substantiated in the Ramboll Evaluation, where it is observed that the market share of breweries below the reduced rate threshold in FR, DE, and the UK is limited, and that the concentration in these markets is stable. In this study, the market data estimated for the MS where fieldwork was carried out confirm this assessment, as the market share of producers covered by the reduced rate varies from 3% to 10%, while the market share of large brewers is estimated between 75% and 96%. Large beer producers confirmed this view during the fieldwork and expressed no or limited concerns with respect to reduced rates. In a nutshell, they do not perceive this provision as empowering small producers to undercut prices on the beer market, mainly for two reasons. First, diseconomies of scale and barriers to market access are indeed a factor reducing the competitiveness of SME, and the reduced rates are perceived as partially counterbalancing such a disadvantage, rather than putting SME in a privileged competitive position. Secondly, product segmentation on the beer market matters as well, so that small companies mostly focus on craft beer, and large companies on mass products.<sup>227</sup>
- Per capita alcohol consumption.** No or negligible changes to per capita alcohol consumption, and thus negative health impacts, can be attributed to the provision for reduced rates. This is due to the combination of (i) a limited impact on price, as the tax discount is mostly appropriated by the SME; (ii) a limited impact on consumption, as the market affected represents a small share of the overall beer market, and since there is no indication that the consumption of 'reduced rate beer' results in additional consumption in terms of pure alcohol. Also, craft beer, which represents the bulk of production for small brewers, has not been associated with

<sup>225</sup> As in other parts of the reports, it is assumed an average strength of 5% vol or 12° Plato.

<sup>226</sup> COM(2016) 676 Final, p. 14.

<sup>227</sup> The distinction is obviously not neat. All large producers are active in the premium or craft segments, even though these segments represent a lower share of output compared to small breweries. At the same time, breweries under the reduced rate, especially medium breweries in the 50,000 hl to 200,000 hl output range, also manufacture mass products.

hazardous consumption patterns.<sup>228</sup> Views collected from health institutions and NGOs interviewed during the fieldwork confirm these conclusions.

### 2.3.2.2 Functioning of the reduced rates for small distilleries

Albeit providing for a similar mechanism – an excise reduction, a maximum output threshold, and a set of conditions defining ‘independent’ distilleries – the rationale and the functioning of the reduced rates for small distillers are quite different from that for brewers. When discussing this issue with a tax authority implementing the provision, it was clearly stated that the rationale of the reduced rates for small distilleries is to protect and preserve the traditional distilling culture, rather than to promote the competitiveness of SME in the spirits sector. Accordingly, the threshold is set at a much lower level, of about 1/8,000 compared to the one allowed to small brewers.<sup>229</sup>

The commercial viability of such a scale of production is very limited. Though considerations vary depending on the type of spirits and the % vol, this scale could be viable only for distilleries of ultra-premium products. As such, this provision currently serves to protect ancillary ‘traditional’ production, such as that of fruit farmers in Austria and Germany, or wine makers in Southern Europe (Portugal).<sup>230</sup> Those distilleries are more likely to work on an occasional basis, e.g. after fruit harvesting or grape pressing. They can sell their products, but their market is very local.

Having such rationale in mind, a straightforward comparison of the threshold for small distillers with that for brewers would be a comparison of provisions with different objectives; as such, it may be appropriate that these provisions cause different impacts in the market. However, it is also possible that the provisions for small distilleries suffer from poor regulatory design, i.e. that the level of the threshold is too low to be fit for purpose. Noteworthy, in the OPC, most of the producers in the ethyl alcohol industry expressed a negative opinion on the current threshold, but while a quarter considered it, expectedly, too low, more than half of them considered it too high – probably expressing a general discontent with the granting of reduced rates to small distilleries. SME in the ethyl alcohol sector also expressed the view that the threshold is too high.

Under these circumstances, the provision has very limited impacts on the distillery sector. Only 7 MS have implemented it (and Slovenia only did so as of this year). Moreover, in some of these countries – Germany and Austria<sup>231</sup> – other simplified regimes for ancillary distillers exist, which not only provide for a reduced rate, but also for a simpler administration. To provide an idea of how small impacts in the baseline scenario are, in France, which did not implement the reduction, distilleries of about 10 hlpa of capacities are estimated to represent 0.04% of the spirit market; in Poland, distilleries up to 100 hlpa – 10 times the current threshold – would represent at best 0.4% of the production. As a consequence, the impact on spirit markets is negligible,<sup>232</sup> the volume of products subject to reduced rates being tiny and sold only locally, usually ‘at farm’s gate’. The very limited volume of spirits concerned make any change in per capita alcohol consumption or foregone revenue immaterial. Any cross-border dimension is lacking, given that hardly any distillery of this size could find entering a foreign market profitable. Administrative burdens or enforcement costs that can be linked to this provision are also minimal, considering that the regime would not cost companies more than their equivalent small brewer scheme and that the costs of the latter are minimal,

<sup>228</sup> Interview with health authorities.

<sup>229</sup> Assuming a spirit at 40% vol, the threshold for small distillers, expressed in hl of products, amounts to 25 hl.

<sup>230</sup> Ibid.

<sup>231</sup> See Section 2.3.1 above.

<sup>232</sup> As stated in the COM(2016) 676 Final, at p. 12.

and considering that customs authorities would not deploy significant resources on ancillary activities, where the tax risk is negligible. These findings were confirmed by stakeholders both in MS where the reduced rates were introduced and, from a counterfactual perspective, in MS where this is not the case.

### 2.3.2.3 Treatment of small producers of other alcoholic beverages

The Directive does not allow MS to grant a reduced rate to small producers of beverages other than beer and ethyl alcohol. This different treatment may result in a distortion of competition between different beverages. However, focusing only on the possibility to access reduced rates as the force determining competitive conditions would represent a too narrow problem definition.

First, the strength of the competition across alcoholic beverages, or in other words whether they fall in the same relevant market, should be considered. When considering the established practice in EU competition cases, markets for alcoholic beverages are largely defined along product lines, so that beer,<sup>233</sup> wine,<sup>234</sup> other fermented beverages, or spirits<sup>235</sup> belong to different relevant markets.<sup>236</sup> In the economic analysis, cross-price elasticities for alcoholic drinks, measuring the consequences on the consumption of beverage A when the price of beverage B changes, are considered mostly non-significant or very small.<sup>237</sup> As such, the different treatment granted to small brewers and distillers might not represent a competitive distortion, because of the very limited degree of inter-market competition.

Also, reduced rates are only one of the elements determining the competitive conditions for small producers of different alcoholic beverages. At least two other regulatory drivers need to be taken into account:

1. **Minimum and actual duty rates.** While small producers of wine and other fermented beverages may not be granted reduced rates, they are subject to a zero rate in a number of MS. Where the excise duty is zero (or very low as in France), reduced rates would not be a policy lever to promote their competitiveness; to the contrary, most of stakeholders and part of the public authorities interviewed perceive that the introduction of reduced rates for small producers risks leading to the subsequent removal of the zero rate for wine. More in detail:
  - a) still wine is subject to a zero rate in 14 MS, representing respectively 72%<sup>238</sup> of the production and 58%<sup>239</sup> of the consumption. Furthermore, in France, the excise duty on wine is positive, but very low, at 3.77 €/hl;<sup>240</sup> including France, the 15 MS with a zero or near-zero rate represent 98% of production and 78% of consumption.

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<sup>233</sup> For beer, the market could be further segmented into on-trade and off-trade, and possibly, along types of beer. See European Commission (DG COMP), 'Case M.7887 – AB Inbev / SAB Miller', May 2016.

<sup>234</sup> For wines, the market usually includes still wine, sparkling wine, wine aperitifs, and fortified wine. The market for still wine can be further segmented based on the colour and on denominations, but the Commission practice is not established in this area. See European Commission (DG COMP). 'Case No Comp/M.5114 – Pernod Ricard / V & S', 2008.

<sup>235</sup> For spirits, the markets are defined as 'no wider than those for each of the internationally recognised main spirits types (whiskey, gin, vodka, rum, etc.) and for each liqueur. See European Commission (DG COMP), 'Case No Comp/M.2269 – Pernod Ricard / Diageo / Seagram Spirits', May 2001, at §14.

<sup>236</sup> See European Commission (DG COMP), 'Case M.7887 – AB Inbev / SAB Miller', May 2016.

<sup>237</sup> See HM Revenue and Customs, 'Estimation of price elasticities of demand for alcohol in the United Kingdom'; HMRC Working Paper 16, 2014.

<sup>238</sup> European Commission (DG AGRI), '2016-2017 Harvest Forecast', 2016.

<sup>239</sup> IWSR Data.

<sup>240</sup> As a comparison, the unweighted average of the positive excise duty rates in the EU is 139.81 €/hl.

- b) Sparkling wine is subject to a zero rate in 8 MS, representing respectively 41% of the production<sup>241</sup> and 31% of the consumption.<sup>242</sup> Considering France, zero and near-zero rate MS represent 69% of the production and 49% of the consumption.
- c) Still or sparkling cider and perry are subject to a zero rate in 9 MS, representing 9% of the consumption. Considering still cider and perry only, it is subject to a zero rate in 13 MS, representing 14% of consumption.<sup>243</sup>

2. **Access to simplified regime.** Small wine producers – and consequently producers of other fermented beverages<sup>244</sup> – may be exempted from the duty to set up a tax warehouse and from most of the requirements concerning holding and movements of excisable goods.<sup>245</sup> These requirements generate significant costs for small producers. For example, in the UK, the cost of setting up a tax warehouse for small cider makers have been estimated at about EUR 2,300 by economic operators. When discussing with an Italian producer about the costs that he was about to incur because of exceeding the output threshold of 1,000 hl, he estimated that the setting up of a tax warehouse generated one-off expenses for about EUR 5,000, the bulk of it linked to the calibration of his production equipment, on top of recurring annual costs linked to recordkeeping (which he was unable to estimate, as they did not yet materialise).

However, even though inter-market competition is not at risk, intra-market effects may be at play. In particular, MS have limited power to correct potential market imbalances in wine, other fermented beverage, or intermediate product markets,<sup>246</sup> be they the diseconomies of scale or market access barriers, or the protection of traditional productions. This limitation in MS flexibility could be a case of poor regulatory design. As a consequence, the Council has invited the Commission to investigate the impact of extending the rules to small producers of other beverages.<sup>247</sup>

#### 2.3.2.4 Dynamic baseline scenario

With respect to the impacts of reduced rates for small brewers, in most of the countries analysed in-depth the number of microbreweries is growing at a very fast pace. Even though the rate of growth is likely to diminish in the future as the market achieves a higher level of maturity, there is no indication at this stage that the phenomenon is halting.<sup>248</sup> As a consequence, the market share of small brewers could increase, but, so far, the growth in the number of players was not matched by a parallel increase in their market share, nor in the overall size of the beer market. As such, there is a limited expectation that market effects (i.e. competitive distortions), costs to the public budget, or negative health impacts would become more prominent in the future. On the other hand, administrative burdens and enforcement costs are more likely to increase linearly or quasi-linearly as the number of players increases, but they would probably be as limited as in the baseline situation, in both absolute and relative terms. At the same time, as the sector of small brewers achieves maturity and some players grow in size, it is likely that (i) cross-border trade flow augments, so that the not always smooth functioning of the scheme in MS other than that of establishment becomes a more significant problem; and (ii) the

<sup>241</sup> International Organisation of Vine and Wine (OIV), 'OIV's Focus – The sparkling wine market', 2014.

<sup>242</sup> IWSR Data.

<sup>243</sup> AICV, 'European Cider Trends 2016 – Update', 2015 (national association for PL).

<sup>244</sup> Based on Article 15 of the Directive.

<sup>245</sup> Based on Article 40 of the Horizontal Directive. See Section 2.3.1 above.

<sup>246</sup> IIA, at p.5.

<sup>247</sup> Council Conclusions (2016), at §8.

<sup>248</sup> British Beer & Pub Association, 'Small Brewer Relief and the impact on future market structure – Discussion paper', 2016.

commercial relationships become more complex, and more forms of cooperation could be part of the grey areas identified above.

With respect to the other two sub-problems discussed above, the situation is not likely to change in the near future. The uptake of the provision for small distilleries across MS is not expected to increase, according to the tax authorities interviewed, and only in the UK and Belgium – out of the 6 countries visited – there seem to be an upward trend in the very small distillery market. The number of operators concerned by the provision is thus unlikely to grow significantly. With respect to small producers of other alcoholic beverages, the current imbalances within the markets will remain unaffected should no change to the current situation be introduced.

➤ **SUMMARY OF PROBLEM ANALYSIS**

<b>Problem drivers</b>	<b>Adverse effects</b>	<b>Expected evolution</b>
<b>Issues with the application of reduced rates to small brewers</b>	<ul style="list-style-type: none"> <li>Lack of clarity concerning the application of the reduction to certain forms of cooperation between small brewers may create legal uncertainty and litigation costs</li> <li>Application of the reduction to operators located in other MS is hampered in a limited number of cases because of administrative requirements</li> </ul>	<ul style="list-style-type: none"> <li>The growth in the micro and small brewery segment is likely to increase the complexity of the market and the weight of cross-border trade, so that the magnitude of the problem is likely to increase (albeit from a small level)</li> </ul>
<b>Issues with the application of reduced rates to small distilleries</b>	<ul style="list-style-type: none"> <li>Though the threshold is appropriate for ancillary producers, the limited take up of the provision may be due to the fact that the maximum output is hardly fit for operators at a commercial scale</li> </ul>	<ul style="list-style-type: none"> <li>No additional MS likely to opt in to the provision; the number of commercial operators falling below the threshold will remain marginal</li> </ul>
<b>Uneven treatment of small producers of other alcoholic beverages</b>	<ul style="list-style-type: none"> <li>The Directive provisions prevent MS from correcting potential market imbalances</li> </ul>	<ul style="list-style-type: none"> <li>Market imbalances would remain unaddressed, but stable</li> </ul>

## 2.4 Reduced rates for low-strength alcohol

Articles 5, 9, 13, 18, and 22 of the Directive allow MS to apply reduced rates on low-strength alcoholic beverages for all categories of products, i.e. beer, wine, other fermented beverages (OFB), intermediate products, and ethyl alcohol. This Section first provides a baseline assessment detailing, for each category of product: i) the EU and national definitions of low-strength alcoholic beverages; ii) the market features of low-strength alcohol; iii) the national structure and level of excise duty; and iv) the current tax impact of reduced rates on low-strength alcoholic beverages at MS level. Then, we discuss the main problems stemming from the current EU legal framework and its national implementation, with a view to identify issues for revision of the current policy framework. Country level analysis focuses on six MS covered via fieldwork, i.e. Belgium, Finland, Italy, Poland, Romania and the United Kingdom (UK).

### 2.4.1 Baseline assessment

The analysis of low-strength alcohol have to be conducted at the level of the five product categories defined in the Directive since, as shown below, major differences exist when it comes to product definition, alcohol content thresholds, market features, excise duty, tax revenues, etc. Before moving to the analysis by category of product, however, it is worth providing some background information, which is relevant to all categories:

- For each category, the Directive defines the thresholds in terms of actual alcoholic strength by volume under which MS may apply reduced rates: 2.8% vol for beer; 8.5% vol for wine and OFB; 15% vol for intermediate products; and 10% vol for ethyl alcohol.
- In all product categories, beverages with an alcohol content not exceeding 1.2% vol are considered as 'alcohol-free' by the Directive; therefore, they are not subject to excise duty. The only exception is represented by beer, where the Directive sets a lower threshold (0.5% vol) to apply the definition of 'alcohol-free' product.
- Depending on the category of products, excise duty (and hence reduced rates) is either applied as: i) per hectolitre of product (wine, OFB and intermediate products); or ii) per hectolitre / ABV (ethyl alcohol and beer in some MS), or per hectolitre / Plato degree (beer, in some MS). This difference implies that excise duty on beer and ethyl alcohol is somehow proportional to their actual alcoholic strength, whereas the excise duty on wine, OFB, and intermediate products is proportional to the overall volume (in litres) of product, irrespectively of its alcoholic strength.
- Directive 92/84/EEC establishes positive, minimum excise duty for beer, intermediate products and ethyl alcohol. Conversely, there is no positive minimum excise duty for wine and OFB. Consequently, wine and OFB in several MS are exempted from excise duty, irrespectively of their alcohol content (but below the thresholds established in Directive 92/83/EEC).
- Reduced rates for low-strength beer, wine, OFB, and ethyl alcohol can be below the minimum rates of Directive 92/84/EEC. It is not entirely clear, if reduced rates can be even set at zero or needs to be positive. By contrast, the Directive specifies that the reduced rate for intermediate products shall be neither less than 40% of the standard national rate, nor lower than the standard national rate on still wine and other still fermented beverages.<sup>249</sup>
- Finally, the Directive enables MS to apply different reduced rates to different alcoholic strength 'brackets' (below the maximum threshold) for beer, wine, OFB,

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<sup>249</sup> Different thresholds apply to some specific Intermediate Products such as those covered by Regulation 4252/88 or sparkling intermediate products.

and ethyl alcohol. In this respect, bearing in mind that the minimum excise duty on wine and OFB is set at zero by Directive 92/84/EEC, for these two categories MS have enough flexibility to introduce different rates for different segments both below and above the 8.5% vol threshold, without any constraint on the level of such rates. By contrast, only a single reduced rate can be applied to intermediate products below 15% vol.

#### 2.4.1.1 Beer

##### ➤ DEFINITION OF LOW-STRENGTH BEER

Beer is not defined in the EU legislation and national definitions vary across MS. In the same vein, the definition of low-strength beer varies between MS. For instance, while for tax purposes some MS, such as Finland, define low-strength beer as any beer with an actual alcoholic strength by volume between 0.6% vol and 2.8 % vol,<sup>250</sup> in the UK beer qualifies as low-strength if its actual alcoholic strength by volume ranges between 1.3 % vol and 2.8% vol.<sup>251</sup>

Also in those countries where reduced rates are not applied to low-strength beer, diverging definitions of such product exist. By way of example, in Belgium beer is considered as low-strength if its actual alcoholic strength by volume is between 0.6% vol and 1.2% vol.<sup>252</sup> By contrast, in Italy, whereas low-strength beer has alcohol content between 1.2% vol and 3.5% vol, beer below 1.2% vol is considered as alcohol-free.<sup>253</sup>

##### ➤ MARKET FOR LOW-STRENGTH BEER

Based on IWSR data and definitions, in 2015 the market for low-strength and alcohol-free beer represented about 4% of the beer market's total value in Europe; this estimate comprises also alcohol-free beer (below 0.5% vol), which is outside of the scope of the Directive.<sup>254</sup> Focusing on EU consumption of low-strength beer (containing between 0.6% vol and 2.8% vol), the IWSR database points at a share of some 1.4% of total beer consumption in 2015 (Figure 9).<sup>255</sup> This number grew by 70% since 2010, when low-strength beer had a market share of about 0.8% at the EU level (Figure 9). Results from the OPC conducted on the topic confirm this increasing trend. Indeed, about 60% of participants who responded to this question believe that the consumption of low-strength beer is increasing moderately and about 15% believe that the consumption of low-strength beer is increasing significantly.

In all MS covered by the fieldwork, the market for low-strength beer grew between 2010 and 2015. More specifically, in Italy and the UK there was basically no market for low-strength beer in 2010, while in 2015 the market share was above 1% and 0.5% respectively. In Belgium, the market grew by five times, in Romania by a factor of 13, albeit from a very small base. Interestingly, although market shares for low-alcohol beer have been increasing since 2010, they remain marginal in all selected MS.

<sup>250</sup> See Excise Duty Tables (2017).

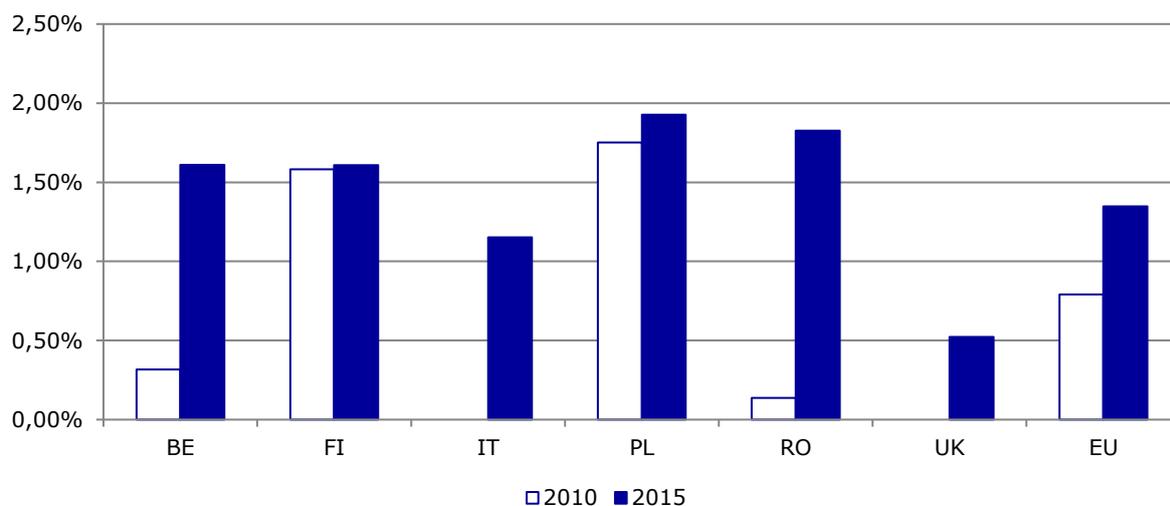
<sup>251</sup> For further details, see HMRC (2017), *Alcohol Duty Rates from 13 March 2017*, available at: <https://www.gov.uk/government/publications/rates-and-allowance-excise-duty-alcohol-duty/alcohol-duty-rates-from-24-march-2014#beer> (last accessed on 21 June 2017).

<sup>252</sup> For further details, see *31 Mars 1993 - Arrêté royal concernant la bière* (MB 1993 06 04).

<sup>253</sup> For further details, see *Legge 16 agosto 1962, n.1354* and following amendments.

<sup>254</sup> The estimate includes two beer categories identified by IWSR: i) 'low-alcohol beer'; and ii) 'radler'.

<sup>255</sup> The estimate includes only the 'radler' category as defined by IWSR. In fact, the 'low-alcohol' category appears to cover mostly alcohol-free beer. This conclusion is based on the identification of the alcohol content of a sample of 13 products comprised in the 'low-alcohol' category and 14 products comprised in the 'radler' category in five MS: Belgium, Italy, Poland, Romania and the UK.

**Figure 9 – Market share for low-strength beer (>0.5% and ≤2.8% vol) out of total market for beer (volume) in selected MS**

**Source:** Author's elaboration of IWSR database and Panimoliitto statistics (for Finland).

Beer producers interviewed for this Study have stressed that several factors may explain the limited market share for low-strength beer in all MS: i) in many national markets low-strength beer (both radler and low-strength standard beer) is a rather innovative product, which has still to gain market confidence compared to standard beer; ii) producing low-strength beer costs more than producing standard beer, therefore only (certain) large beer producers can absorb the greater production costs, (and the product is usually sold at a premium price); and iii) low strength beer may taste differently and, reportedly, might not appeal standard beer consumers, while at the same time consumers highly sensitive to health and well-being might still prefer alcohol-free beer.<sup>256</sup>

#### ➤ REDUCED RATE ON LOW-STRENGTH BEER AND ESTIMATED TAX IMPACT

Among the six MS covered via fieldwork, only Finland and the UK introduced reduced rates for low-strength beer (Table 35). Finland applies reduced rates to beer with an actual alcoholic strength by volume comprised between 0.6% vol and 2.8% vol; the reduced rate is about one-quarter of the standard rate. The UK applies reduced rate for beer with an actual alcoholic strength by volume comprised between 1.3% vol and 2.8% vol;<sup>257</sup> the reduced rate is about half the standard rate.

**Table 35 – Excise duty and reduced rates for low-strength beer in selected MS (as of January 2017)**

MS	Standard rate	Reduced rate
Belgium	€2.00/hl/° Plato	n/a
Finland	€32.05/hl/% vol	€8.00/hl/% vol (between 0.6% vol and 2.8% vol)
Italy	€3.02/hl/° Plato	n/a
Poland	€1.81/hl/° Plato	n/a
Romania	€0.74/hl/° Plato	n/a

<sup>256</sup> In Italy and Poland, large producers are in the process of launching low-strength standard beer with alcohol content at around 3.5% vol, which is expected to be more appealing for wellness-oriented consumers in search for low-alcohol, low-calories alcoholic beverages.

<sup>257</sup> In the UK whereas beer below 1.3% vol is exempted from excise duty, beer above 7.5% vol is subject to a rate higher than the standard.

MS	Standard rate	Reduced rate
UK	€18.37/hl/% vol (between 2.9% vol and 7.5% vol)  €23.85/hl/% vol (above 7.5% vol)	€9.28/hl/% vol (between 1.3% vol and 2.8% vol)

**Source:** *Excise Duty Tables (2017)*.

In the UK, a reduced rate on low-strength beer was first introduced in the second half of 2011. National beer producers argued that foregone tax revenues linked to reduced rates are very small; this is confirmed by available evidence. By focusing on 2015 figures by HRMC, which are largely aligned with IWSR data, the foregone tax revenues (excise duty) linked to reduced rates on low-strength beer were in the region of EUR 6.6 million, i.e. less than 0.2% of the total tax revenues from excise duty on beer in the UK. Two estimates of foregone revenues were constructed. First, a lower bound estimate assuming low-strength beer sold contained 1.3% vol. Then, an upper bound estimate assuming low-strength beer sold contained 2.8% vol. A point estimate was finally computed as the simple average of these two scenarios. Such analysis most likely overestimates foregone revenues, if one considers that any increase in rates on low-strength beer might reduce this market also in favour of alcohol-free products, which are not subject to excise duty.

In a similar fashion, foregone tax revenues in Finland appear to be quite limited, i.e. in the region of 0.4% of total tax revenues from excise duty on beer in 2015 (including VAT on excise duty). This share is slightly bigger than the one estimated for the UK for two main reasons: i) the difference between the standard rate and reduced rate is larger in Finland; ii) the definition of alcohol-free beer is stricter in Finland (alcohol content lower than 0.6% vol) than in the UK (alcohol content lower than 1.3% vol). At any rate, Finnish authorities confirmed that forgone revenues linked to reduced rates are very limited and almost negligible when accounting for the share of consumers that would go for alcohol-free options in the absence of reduced rates. It is worth stressing that Finland currently applies the highest excise duty to beer in the EU.

#### 2.4.1.2 Wine

##### ➤ DEFINITION OF LOW-STRENGTH WINE

Article 9.2 of the Directive enables MS to apply reduced rates to both still and sparkling wine with an actual alcoholic strength by volume not exceeding 8.5% vol. It is worth underlining that this threshold is not aligned with the EU and international definition of (standard) wine. According to the International Organisation of Vine and Wine (OIV), the actual alcoholic strength by volume of wine should not be below 8.5% vol.<sup>258</sup> In a similar fashion, Regulation (EU) No. 1308/2013<sup>259</sup> establishes a minimum actual alcoholic strength by volume of 8.5% vol for both still<sup>260</sup> and sparkling wine<sup>261</sup>.

<sup>258</sup> For further details see OIV, 'International Standards for the Labelling of Wines', 2015; special legislation at the regional level can reduce this minimum actual alcoholic strength by volume to 7% vol, depending on 'climatic conditions, soil or grape variety, special qualitative factors or individual traditions specific to certain vineyards'.

<sup>259</sup> See Regulation (EU) No 1308/2013 of the European Parliament and of the Council of 17 December 2013 establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) No 922/72, (EEC) No 234/79, (EC) No 1037/2001 and (EC) No 1234/2007 (hereinafter: 'Regulation 1308/2013'); the minimum alcohol strength is 9% vol, if wine is derived from grapes harvested in some specific wine-growing zones.

<sup>260</sup> Wine with a protected designation of origin or a protected geographical indication may have an actual strength of not less than 4.5%. Reportedly, this type of wine represents a niche product.

<sup>261</sup> Some special sparkling wine such as 'quality aromatic sparkling wine' may have minimum alcohol strength of 6% vol; in the same vein, some 'semi-sparkling wine' and 'aerated semi-sparkling wine' may have an actual alcoholic strength by volume of not less than 7% vol. These also appear to be niche products.

When it comes to tax purposes, Finland and the UK apply different rates to different brackets of alcohol content. In Finland, low-strength wine has an alcohol content not-exceeding 8.0% vol; in the UK, low-strength still wine must have less than 5.6% vol.<sup>262</sup> Belgium applies one single reduced rate on wine below 8.5% vol.

#### ➤ MARKET FOR LOW-STRENGTH WINE

As mentioned, wine must have actual alcoholic strength by volume above 8.5 % vol, with few exceptions (e.g. PDO/PGI wines such as *Moscato d'Asti*)<sup>263</sup> that are niche products. In this context, the 8.5% vol threshold appears to be relevant only to some special wine and products derived from wine;<sup>264</sup> 'wine-based' drinks, however, are not necessarily classified as 'wine' for tax purposes.<sup>265</sup> Consequently, the market share for low-strength wine (below 8.5% vol) is limited in all MS.

The IWSR database allows identifying the following types of wine/wine-based drinks that most likely include some products below 8.5% vol: i) fruit-flavoured still wine; ii) *Asti*, *Lambrusco* and fruit-flavoured sparkling wine; iii) *sangria*, *gluehwein*, and possibly other aromatised wine products.<sup>266</sup> By allotting a share of total consumption of these products to the low-strength segment,<sup>267</sup> it is possible to provide a rough estimate of the market share for low-strength wine in selected MS and in the EU as a whole (Figure 10). Low-strength wine would represent about 1.2% of the overall market for wine at the EU level. A growing trend was registered between 2010 and 2015 in all surveyed MS.<sup>268</sup> In Italy, the market share was about 2% in 2015; this was mainly due to some consumption of low-strength Lambrusco, which is less common in other MS.

<sup>262</sup> See Excise Duty Tables (2017).

<sup>263</sup> Moscato D'Asti has an actual alcohol content between 4.5% vol and 6.5% vol.

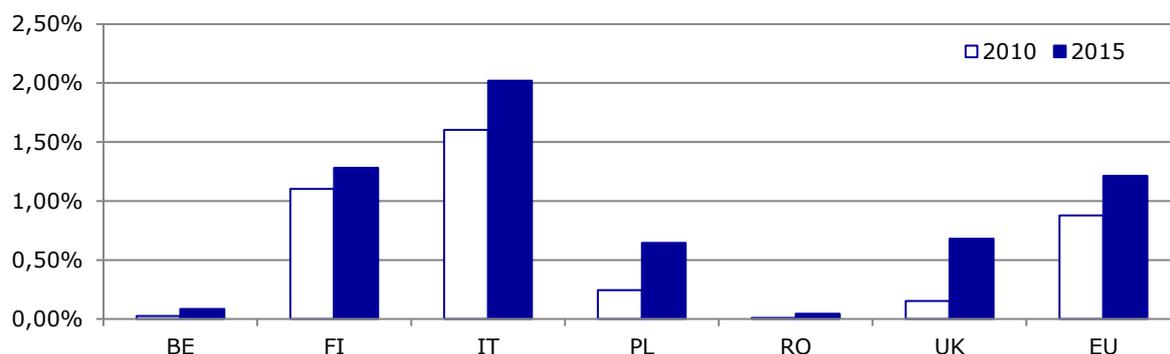
<sup>264</sup> Below 8.5% the following categories of special wines and products derived from wines can be identified: i) sweet wines with residual sugar derived from grapes (alcohol content not lower than 4.5%); ii) 'icewine' (alcohol content not lower than 5.5%); iii) wine-based beverages (alcohol content not lower 4.5% for wine-based drinks and 1.2% for wine-based cocktails; Regulation 251/2014 of the European Parliament and of the Council of 26 February 2014 on the definition, description, presentation, labelling and the protection of geographical indications of aromatised wine products and repealing Council Regulation (EEC) No 1601/91, OJ L 84, 20.3.2014, p. 14–34); iv) beverages obtained by dealcoholisation of wine (alcohol content below 0.5%); v) beverages obtained by partial dealcoholisation of wine (alcohol content not lower than 0.5% and below thresholds for wine and special wine). For further details, see OIV, 'Definition of the vitivinicultural products by code sheet', 2016, available at: <http://www.oiv.int/public/medias/3996/products-definition-en.pdf> (last accessed on 4 July 2017).

<sup>265</sup> Reportedly, for tax purposes, aromatised wine-based drinks and wine-product cocktails below 7% vol are classified as either OFB or intermediate products. They are included in the wine category only if they are above 7% vol and without addition of alcohol.

<sup>266</sup> *Sangria* and *gluehwein* are aromatised wine-based drinks, which can be classified in the 'wine' category when above 7% vol.

<sup>267</sup> The alcohol content of Asti sparkling wine generally varies between 6% vol and 9.5% vol; therefore, under the assumption of a homogenous distribution across alcohol strength segments, it is estimated that about 70% of the consumption fall within the low-strength segment. In the same vein, Lambrusco's alcohol content usually varies between 7.5% vol and 12% vol; hence, some 20% of the consumption can be allotted to the low-strength segment. As for flavoured sparkling wines and fruit flavoured wines, it is more difficult to establish an exact range for alcohol content due to the large variety of products covered; at any rate, most of the products sold online range between 7.5% vol and 9.5% vol and it is reasonable to assume that 50% of such products can be considered low-strength wine. Finally, all products included in the *sangria* and *gluehwein* segment are assumed not to exceed 8.5% vol; this assumption could lead to an upper bound estimate of the market share for low-strength wine.

<sup>268</sup> Although around two-third of participants in the OPC who responded to this question reported that, to their knowledge, consumption of low-strength wine is stable.

**Figure 10 – Market share for low-strength wine (<8.5% vol) out of total market for wine (volume) in selected MS**

**Source:** Author's elaboration of IWSR database.

### ➤ REDUCED RATE ON LOW-STRENGTH WINE AND ESTIMATED TAX IMPACT

Among the six MS covered via fieldwork, Belgium, Finland and the UK apply reduced rates to low-strength wine (Table 36). It goes without saying that MS applying a zero rate to wine (such as Italy and Romania for still wine) did not opt for reduced rates.

**Table 36 – Excise duty and reduced rates for low-strength wine in selected MS (as of January 2017)**

MS	Standard rates (still wine)	Standard rates (sparkling wine)	Reduced rates
Belgium	€74.91/hl	€256.32/hl€	€23.91/hl (between 1.3% vol and 8.5% vol) €22.00/hl (between 1.3% vol and 2.8% vol)
Finland	€339.00/hl	€339.00/hl	€169.00/hl (between 2.9% vol and 5.5% vol) €241.00/hl (between 5.6% vol and 8.0% vol)
Italy	€0/hl	€0/hl	n/a
Poland	€36.80/hl	€36.80/hl	n/a
Romania	€0/hl	€10.65/hl	n/a
UK	€318.19/hl	€407.56/hl	€98.03/hl (still wine between 1.3% vol and 4.0% vol) €134.82/hl (still wine between 4.1% vol and 5.5% vol) €308.06/hl (sparkling wine between 5.6% vol and 8.5% vol)

**Source:** Excise Duty Tables (2017).

In surveyed MS applying reduced rates on low-strength wine, the foregone tax revenues linked to the reduction represent a marginal share of the maximum tax revenues from excise duty on wine in 2015.<sup>269</sup> More specifically, foregone revenues are: i) less than 0.2% of total revenues in Belgium, where the reduction is significant (reduced rate is one-third of the standard rate on still wine and one-tenth of the reduced rate on sparkling wine) and applies to all wine not exceeding 8.5% vol; ii) about 0.3% in Finland, where the reduction applies to wine not exceeding 8.0% vol and consumption of low-strength wine is above 1% of total consumption; iii) less than 0.1% in the UK, where the reduction basically applies only to sparkling wine up to 8.5% vol, as the consumption of still wine with alcohol content up to 5.6% vol is most likely negligible.

<sup>269</sup> As the Excise Duty Tables (Tax Receipts) provide aggregate tax revenues for both wine and OFB in most MS, the Consultants estimated the maximum revenues from excise duty on wine by applying the standard rate for still/sparkling wine to the entire national consumption of still/sparkling wine (IWSR data).

### 2.4.1.3 Other Fermented Beverages

#### ➤ DEFINITION OF LOW-STRENGTH OFB

Traditional OFB mainly include cider, perry, mead, and fruit wines. Most of cider and perry have an alcohol content between 1.2% and 8.5% vol. Fruit wines instead can range from 6% vol to 14% vol.<sup>270</sup> These products are not defined by Union law. According to the Code of Practice drafted by AICV<sup>271</sup>: i) cider and perry contain alcohol within the range of 1.2% vol to 8.5% vol and should maintain the character of fermented apple/pear juice;<sup>272</sup> ii) fruit wine instead has an alcohol content above 1.2% vol, with no upper limit; iii) low-alcohol cider, perry and fruit wine contain more than 0.5% vol and less than 1.2% vol; iv) alcohol-free cider, perry and fruit wine contain less than 0.5% vol. Cider, perry and fruit wine may be carbonated by fermentation or by injection of carbon dioxide or uncarbonated.

National definitions of such beverages vary across MS. For instance, in Belgium and Italy there is no specific definition besides the one provided by the Directive for tax purposes. In Finland, cider and perry are produced by fermentation from apples or pears and have an alcohol content comprised between 2.8% vol and 8.5% vol.<sup>273</sup> In the UK, cider is defined as '*cider or perry of a strength exceeding 1.2% alcohol by volume (ABV) but less than 8.5% ABV obtained from the fermentation of apple or pear juice without the addition at any time of any alcoholic liquor or of any liquor or substance which communicates colour or flavour other than such as the Commissioners may allow as appearing to them to be necessary to make cider or perry*'.<sup>274</sup> In Poland, cider and perry have an actual alcoholic strength by volume between 1.2% vol and 8.5% vol; by contrast, fruit wine contains alcohol for no less than 8.5% vol, whereas low-alcohol fruit wine has an alcohol content between 0.5% vol and 8.5% vol.<sup>275</sup>

Fragmentation is apparent also when looking at MS applying reduced rates. Belgium, for tax purposes, relies on the definition spelled out in the Directive; hence, low-strength OFB contain no more than 8.5% vol. In Finland, reduced rates are applied to a menu of brackets, with the upper threshold equal to 8.0% vol. In Poland, cider and perry with alcohol content of no more than 5.0% vol benefit from a reduced excise duty. In the UK, low-strength OFB do not exceed 8.5% vol; yet, when it comes to reduced rates there are different brackets for still cider and perry, sparkling cider and perry and still/sparkling OFB other than cider and perry.

#### ➤ MARKET FOR LOW-STRENGTH OFB

As previously mentioned, based on product definitions, most of the market for OFB does not exceed 8.5% vol.<sup>276</sup> Interviews with cider, perry and fruit wine producers in different MS confirmed this situation. Consumption of OFB appears to be concentrated in few MS.

<sup>270</sup> This includes also fortified fruit wine. Jarvis B., 'Cider, perry, fruit wines and other alcoholic fruit beverages' in *Fruit Processing* edited by Arthey D. and Ashurst P.R.

<sup>271</sup> AICV, 'Code of Practice', 2015.

<sup>272</sup> An exception is represented by '*cidre de glace*', a beverage made from the fermentation of frozen apples/pears with an alcohol content above 7% vol. In addition, in countries where there is no tradition for cider/perry, it is common to use the term 'apple wine' and 'peer wine' for a high gravity apple cider base and peer cider base with an alcohol content between 9% vol and 12% vol, which is usually used as a primary ingredient in the production of cider and perry.

<sup>273</sup> See 'Alcohol Act 1143/1994', 'Alcohol Beverage Decree 1344/1994', 'Excise Act 182/2010', 'Alcohol Tax Act 1471/1994' as referred to in the Code of Practice AICV.

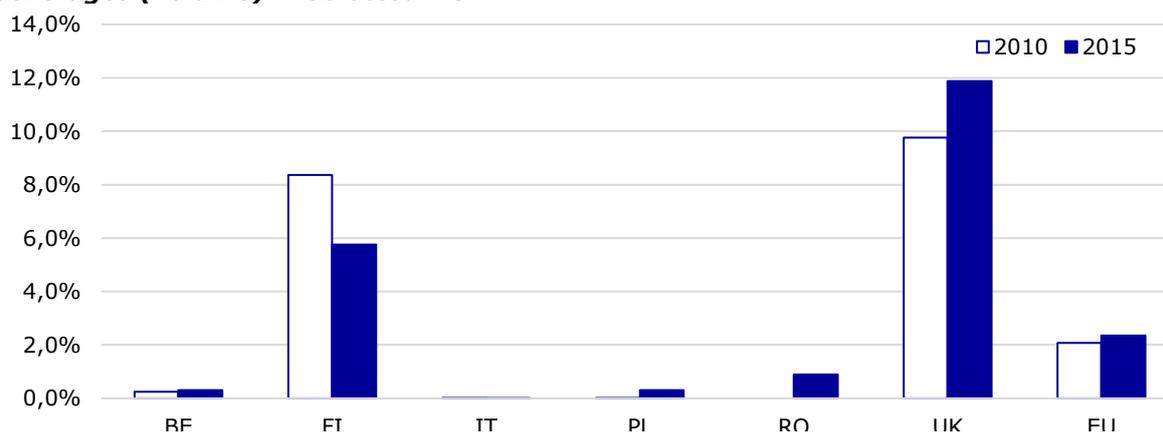
<sup>274</sup> See 'Alcoholic Liquor Duties Act 1979', paragraph 5.5, Section 25.

<sup>275</sup> See 'Dz.U. 2011 no 120 poz. 690, Ustawa z dnia 12 maja 2011 r. o wyrobie i rozlewie wyrobów winiarskich, obrocie tymi wyrobami i organizacji rynku win'.

<sup>276</sup> It is worth mentioning that, in some MS, the category OFB may also include aromatised fortified wine-based drinks and cocktails with an ABV lower than 7% vol, as well as with an ABV comprised between 7% and 10% vol, where addition of alcohol is authorised.

Focusing on surveyed MS, IWSR data suggest that in 2015 cider, perry and fruit wine were responsible for less than 0.5% of the total volume of alcoholic beverages consumed in Belgium, Italy, Poland and Romania. By contrast, this share reaches almost 5.5% in Finland and 12% in the UK. In 2015, the UK market for cider, perry and fruit wine represented more than half of the entire EU market. The overall European market for cider, perry and fruit wine recorded a moderate growth between 2010 and 2015; such result is in line with responses to the OPC (46% of participants who responded to this question argued that the market is stable, about 40% that it is moderately growing).

**Figure 11 – Market share for cider, perry and fruit wine out of total market for alcoholic beverages (volume) in selected MS**



**Source:** Author's elaboration of IWSR database.

**Note:** Data for Romania refers only to 2016, as data for previous years are not available.

With regard to fruit wine, the alcohol content tends to be higher (usually above 5.5%) than cider and perry, but still below 8.5% vol, with the exception of fortified fruit wine that generally has an alcohol content above 8.5% vol. In this respect, it is worth mentioning that, based on IWSR data, while in 2015 the market for fortified fruit wine was about 30% of the total market for fruit wine (in volume), the latter was less than 1% of the total market for cider, perry and fruit wine. In the same vein, the actual alcoholic strength by volume of mead may vary by producer and may exceed 8.5% vol; nonetheless, this appears to be a niche product and consumption statistics are not currently available. Against this background, in what follows the analysis will focus only on cider and perry.

#### ➤ REDUCED RATE ON LOW-STRENGTH OFB AND ESTIMATED TAX IMPACT

Belgium and Finland apply reduced rates to low-strength OFB (Table 37); these are the same reduced rates applied to wine (see Table 36 above). The UK allows for reduction on excise duty on consumption of still and sparkling cider and perry. Poland applies two different standard rates: one to cider and perry not exceeding 5.0% vol, and another rate to OFB. In the same vein, Romania applies a zero rate to still cider, perry and mead as well as to sparkling cider and perry; a positive rate is applied to OFB. Finally, Italy applies zero excise duty on all OFB (in the same way as for wine).

**Table 37 –Excise duty and reduced rates for low-strength OFB in selected MS (as of January 2017)**

MS	Standard rates (still OFB)	Standard rates (sparkling OFB)	Reduced rates
Belgium	€74.91/hl	€256.32/hl	€23.91/hl (between 1.3% vol and 8.5% vol)
Finland	€339.00/hl	€339.00/hl	€22.00/hl (between 1.3% vol and 2.8% vol) €169.00/hl (between 2.9% vol and 5.5% vol) €241.00/hl (between 5.6% vol and 8.0% vol)
Italy	€0/hl	€0/hl	n/a
Poland	€36.80/hl	€36.80/hl	€22.59/hl (cider and perry between 1.3% vol and 5.0% vol)

Romania	€89.17/hl €0/hl (still cider, perry and mead)	€10.65/hl €0/hl (sparkling cider and perry)	n/a
UK	-	-	€44.52/hl (still cider and perry between 1.3% vol and 7.5% vol) €67.28/hl (still cider and perry between 7.6% vol and 8.5% vol) €44.52/hl (sparkling cider and perry between 1.3% vol and 5.5% vol) €308.0579/hl (sparkling cider and perry between 5.6% vol and 8.5% vol)

**Source:** *Excise Duty Tables (2017)*.

To estimate the foregone tax revenues generated by the current reduced rates, the following assumptions are required to cope with missing data. First, it is assumed that consumption of cider and perry is equally distributed between the 'still' and the 'sparkling' segments. Second, the distribution of consumption by alcohol content available for the UK is considered relevant also to Belgium, Finland and Poland. Against this background, it is estimated that reduced rates currently generate foregone tax revenues (excise duty) as a share of the maximum tax revenues on cider and perry<sup>277</sup> in the region of 30% in Poland, 45% in Finland, 80% in the UK and 85% in Belgium. Considering the limited size of the market for cider and perry *vis-à-vis* total market for alcoholic beverages, foregone tax revenues are less than 0.5% of total revenues from excise duty on alcohol in Belgium and Poland, about 3% in Finland and some 18% in the UK (the largest EU market for cider and perry).

Finally, it is worth reiterating that almost the entire market for cider and perry is below 8.5% vol and that the application of standard rates to all quantity consumed would lead to a substantial increase in the average price in most MS (from +5% in Poland to +90% in the UK)<sup>278</sup>, thus reducing consumption. Therefore, the analysis above most likely overestimates foregone revenues, if one considers that the decrease in consumption would reduce the revenues generated by excise duty on cider and perry.

#### 2.4.1.4 Intermediate products

##### ➤ DEFINITION OF LOW-STRENGTH INTERMEDIATE PRODUCTS

Article 17(1) of the Directive defines 'Intermediate Products' as all those products falling within CN codes 2204, 2205, and 2206 with an actual alcoholic strength by volume comprised between 1.2% vol and 22% vol, not covered by Articles 2, 8 and 12 of the Directive. Furthermore, the term 'Intermediate Products' may comprise any OFB<sup>279</sup> with an actual alcoholic strength by volume exceeding 5.5% vol and 8.5% vol for still and sparkling beverages respectively, which are not entirely of fermented origin (optional provision). Therefore, this appears to be a residual and variegated category. Examples of intermediate products include some aromatised and fortified wines (e.g. vermouth, Sherry, and Port wine). MS can only apply a single reduced duty rate to intermediate products with an alcoholic content not exceeding 15% vol. Among surveyed MS, this specific threshold has been adopted in all countries opting for reduced excise duty on intermediate products, i.e. Belgium, Finland and the UK.

<sup>277</sup> As the Excise Duty Tables (Tax Receipts) provide aggregate tax revenues for both wine and OFB in most MS, the Consultants estimated the maximum revenues from excise duty on cider and perry by applying the standard rate for still/sparkling cider and perry to the entire national consumption of still/sparkling cider and perry (IWSR data).

<sup>278</sup> Author's elaboration of IWSR data.

<sup>279</sup> As defined by Article 12 of the Directive.

Regulation (EU) 1308/2013<sup>280</sup> establishes alcohol content of wine fortified for distillation, such as Sherry and Port wine; the actual alcoholic strength by volume of such products is comprised between 18% vol and 24% vol. According to Regulation (EU) No. 251/2014,<sup>281</sup> aromatised wine, such as vermouth, must have an actual alcoholic strength by volume comprised between 14.5% vol and 22% vol; yet, aromatised wine up to 15% vol (and up to 18% vol without enrichment) can be included in the 'wine' category. Aromatised wine-based drinks may have an actual alcoholic strength by volume between 4.5% vol and 14.5% vol; yet, they tend to be classified as intermediate products only when above 10% vol and including an addition of alcohol. Finally, aromatised wine-product cocktails may have an actual alcoholic strength by volume higher than 1.2% vol and lower than 10% vol; yet, they are generally classified as OFB up to 7% vol and as a 'wine' when between 7% vol and 10% vol.

#### ➤ MARKET FOR LOW-STRENGTH INTERMEDIATE PRODUCTS

Identifying the size and features of the market for intermediate products is not an easy task, as this is a residual category comprising both traditional products and some new products (e.g. mixed drinks).<sup>282</sup> Based on the IWSR database, the market for traditional intermediate products may include: i) fortified wine, i.e. Sherry (and Sherry-style beverages), Port (and Port-style beverages) and other fortified beverages (e.g. Marsala, Muscat, Pineau des Charentes etc.); ii) aperitifs such as vermouth, 'americano' etc.; and iii) certain aromatised wines like ginger wine and tonic wine. The vast majority of the abovementioned products have an alcoholic content above 15% vol. Therefore, they are not considered low-strength intermediate products. By contrast, certain 'flavoured alcoholic beverages' (FAB) may have an alcohol content lower than 15% vol and be categorised as intermediate products, depending on their alcohol base.<sup>283</sup> Therefore, they may benefit from reduced rates on low-strength intermediate products. Among sampled countries, IWSR data show that in Finland and in the UK, consumption of FAB outnumbers consumption of traditional intermediate products.

#### ➤ REDUCED RATE ON LOW-STRENGTH INTERMEDIATE PRODUCTS AND ESTIMATED TAX IMPACT

Among the selected MS, Belgium, Finland, and the UK opted for reduced rates on low-strength intermediate products (Table 38). More specifically, in Belgium, the reduced rate applies only to still intermediate products with an actual alcoholic strength by volume below 15% vol; in Finland and the UK, it applies to all intermediate products with an actual alcoholic strength by volume ranging from 1.2% vol to 15% vol.

**Table 38 – Excise duty and reduced rates for low-strength intermediate products in selected MS (as of January 2017)**

MS	Standard rates (still intermediate products)	Standard rates (sparkling intermediate products)	Reduced rates
<b>Belgium</b>	€157.78/hl	€256.09/hl	€118.59/hl (still intermediate products between 1.3% and 15% vol)
<b>Finland</b>	€670.00/hl	€670.00/hl	€411.00/hl (between 1.3% vol and 15% vol)
<b>Italy</b>	€88.67/hl	€88.67/hl	n/a

<sup>280</sup> Regulation 1308/2013 of the European Parliament and of the Council of 17 December 2013 establishing a common organisations of the markets in agricultural products and repealing Council Regulation (EEC) No 922/72, (EEC) No 234/79, (EC) No 1037/2001 and (EC) No 1234/2007, OJ L 347, 20.12.2013, p. 671–854

<sup>281</sup> Regulation 251/2014 of the European Parliament and of the Council of 26 February 2014 on the definition, description, presentation, labelling and the protection of geographical indications of aromatised wine products and repealing Council Regulation (EEC) No 1601/91, OJ L 84, 20.3.2014, p. 14–34.

<sup>282</sup> According to participants in the OPC who responded to this question, the market for low-strength intermediate product is rather stable (60% of respondents).

<sup>283</sup> FAB below 10% vol may be classified as OFB; FAB above 10% may be classified as ethyl alcohol.

MS	Standard rates (still intermediate products)	Standard rates (sparkling intermediate products)	Reduced rates
Poland	€74.07/hl	€74.07/hl	n/a
Romania	€89.17/hl	€89.17/hl	n/a
UK	€424.21/hl	€424.21/hl	€318.19/hl (between 1.3% vol and 15% vol)

**Source:** Excise Duty Table (2017).

It is estimated that reduced rates on intermediate products currently generate foregone tax revenues ranging from 25% of the maximum tax revenues on FAB in Belgium and the UK to 39% in Finland. Foregone tax revenues are less than 1% of total revenues from excise duty on alcohol in Belgium and the UK and about 7% in Finland.<sup>284</sup> In addition, the analysis above most likely overestimates foregone tax revenues for two reasons: i) as most of the market for FAB is expected to be below 15% vol, the application of standard rates to all quantity consumed would lead to a substantial increase in the average price in all surveyed MS (from +17% in the UK to +42% in Finland); ii) depending on their alcohol base, FAB may also be classified as OFB or ethyl alcohol.

#### 2.4.1.5 Ethyl alcohol

##### ➤ DEFINITION OF LOW-STRENGTH ETHYL ALCOHOL

Article 22.5 of the Directive allows MS to apply a reduced rate on ethyl alcohol with an actual alcoholic strength by volume not exceeding 10% vol. However, under the EU spirit drinks regulation<sup>285</sup>, any spirit must have a minimum actual alcoholic strength by volume of 15% vol. Therefore, only special products and mixes between spirits and other non-alcoholic beverages may be below 10%. Only Finland applies reduced rates to low-strength ethyl alcohol and sets the threshold at 2.8% vol.

##### ➤ MARKET FOR LOW-STRENGTH ETHYL ALCOHOL

In light with the spirit drinks regulation, the market for low-strength ethyl alcohol does not include any traditional spirits. By contrast, it may include mixed drinks, which can be grouped in three main segments: i) long drinks, i.e. alcoholic beverages mixing a brand/spirit category and non-alcoholic beverages; ii) pre-mixed cocktails, i.e. alcoholic beverages reflecting well-known cocktails containing spirits; and iii) FAB. Long drinks and FAB usually have an actual alcoholic strength by volume of less than 10% vol; therefore, they can be considered low-strength ethyl alcohol. FAB, however, may be also classified as OFB, intermediate products or ethyl alcohol, depending on their alcohol base. In what follows, it is assumed that 100% of FAB is ethyl alcohol, thus providing an upper bound estimate of the market for low-strength ethyl alcohol. Pre-mixed cocktails include both products below 10% vol and products above 10% vol. Therefore, it is assumed that only 50% of the consumption of pre-mixed cocktails can be allotted to the market for low-strength ethyl alcohol.

Based on IWSR data, the estimated market share (in volume) of low-strength pre-mixed cocktails and long drinks grew between 2010 and 2015 at the EU level and represented 2.4% of the total EU consumption of ethyl alcohol in 2015. By contrast, the market share

<sup>284</sup> Foregone tax revenues are computed under the assumption that all FAB have a fermented alcohol base and are classified as intermediate products. This provides an upper bound estimate of foregone tax revenues from reduced rates on intermediate products.

<sup>285</sup> 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, OJ L39, 13.2.2008, p. 16-54.

of FAB decreased, going from 8.7% in 2010 to 6% in 2015. Interestingly, in Poland and Romania, the market for low-strength ethyl alcohol is very limited. In Belgium and Italy, it was in the region of 10% of total consumption of ethyl alcohol in 2015 and mainly included long drinks; in the UK and most importantly in Finland, FAB represented a substantial, but declining share of the market. Participants in the OPC provided a blurred picture: more than half of participants who responded to this question consider this market rather stable, one-quarter believe it is decreasing, one-fifth point at a growing trend.

#### ➤ REDUCED RATE ON LOW-STRENGTH ETHYL ALCOHOL AND ESTIMATED TAX IMPACT

Among surveyed MS, only Finland opted for a reduced rate on low-strength ethyl alcohol (Table 39). This rate equals EUR 800/hlpa and is only applied to ethyl alcohol with an actual alcoholic strength by volume ranging from 1.2% vol to 2.8% vol. The reduced rate applied in Finland on ethyl alcohol is almost six times lower than the standard rate. Nonetheless, ethyl alcohol containing between 1.2% and 2.8% alcohol by volume represents a negligible share of the market for ethyl alcohol. Therefore, the impact of applying reduced rates to low-strength ethyl alcohol on tax revenues in Finland is marginal. This conclusion was confirmed by Finnish stakeholders.

**Table 39 – Excise duty and reduced rates for low-strength ethyl alcohol in selected MS (as of January 2017)**

MS	Standard rates	Reduced rates
Belgium	€2,992.79/hlpa	n/a
Finland	€4,555/hlpa	€800/hlpa (between 1.2% vol and 2.8% vol)
Italy	€1,035.53/hlpa	n/a
Poland	€1,328.58/hlpa	n/a
Romania	€743.06/hlpa	n/a
UK	€3,167.73/hlpa	n/a

Source: Excise Duty Table (2017).

#### 2.4.1.6 Rationale for applying reduced rates on low-strength alcoholic beverages

Overall, MS have used the provisions on reduced rates for low-strength alcohol with flexibility in order to accommodate their own priorities and reflect national specificities, which explains the diverse adoption of reduced rates by different MS (Table 40).

**Table 40 – Reduced rates on low-strength alcoholic beverages in selected MS**

MS	Beer	Wine	OFB	Intermediate products	Ethyl alcohol
Belgium	x	√	√	√	x
Finland	√	√	√	√	√
Italy	x	x	x	x	x
Poland	x	x	√	x	x
Romania	x	x	x*	x	x
The UK	√	√	√	√	x

Source: Excise Duty Tables (2017).

Note: \*Exemption for sparkling still cider, perry and mead and for sparkling cider and perry; √= Reduced rates available; x= Reduced rates not available.

Some countries, such as Finland and the UK, reportedly apply reduced rates based, *inter alia*, on health policy considerations; in fact, reduced rates are expected to encourage the consumption of low-strength products thus decreasing the overall intake of alcohol. Some stakeholders explained that reduced rates may in particular encourage producers to develop innovative low-strength products and enhance the variety of the offer, so as to attract a larger segment of consumers. Conversely, other MS, such as Italy and

Romania, do not to apply reduced rates, and reportedly pursue their health policy objectives via different tools such as awareness-raising and responsible drinking campaigns.<sup>286</sup> In Poland, reduced rates on cider and perry do not (primarily) respond to public health policy concerns but to agricultural/industrial policy needs; in particular, it helped tackling the negative economic effects of the Russian embargo on domestic apple and other fruit growers, offering them new business opportunities. Belgium does not apply reduced rates to low-strength beer and ethyl alcohol, but it does to low-strength wine, OFB, and intermediate products. This is mainly due to the fact that while excise duty on beer and ethyl alcohol are proportionate to the alcohol strength, reduced rates allow introducing elements of proportionality also for the other categories of alcoholic beverages.

The results of the OPC provide an overview of the expected benefits that are, in the participants' view, likely to stem from a greater adoption of reduced excise duty rates for low-strength alcoholic beverages. The overall picture confirms the existence of heterogeneous rationales and perspectives beyond reduced rates to low-strength alcoholic beverages. In particular (see Annexes for details):

- Most of respondents (especially individual and beer industry stakeholders) believe that the application of reduced rates to low-strength alcohol may lead to more choice for consumers and create incentives for product innovation.
- Participants expressed similar views on the utility for SME and large players: reduced rates may help small producers (because they are best positioned to target specific niche markets), as well as large producers, because they tend to have wider product portfolios and may more easily cope with the extra production costs. Among industry stakeholders, these benefits are especially perceived in the beer sector and, to a smaller extent, in the other fermented beverages sector.
- With respect to per capita consumption of alcohol and public health effects, the majority of respondents (58%) believe that the 'net effect' would be positive, since consumers would be encouraged to substitute higher-strength alcoholic beverages with lower-strength ones. On the other hand, some 18% argue that reduced rates may eventually increase alcohol consumption because more affordable products would encourage consumers to drink more.<sup>287</sup>

#### **2.4.1.7 Reduced rates on low-strength alcohol and public health policy**

As confirmed by all the surveyed health institutions and NGOs, there is poor systematic evidence on the public health impact generated by the existing reduced rates for low-strength alcohol in the EU. The main difficulty is the lack of empirical data on the consumption of low-strength alcohol and drinking patterns vis-à-vis the consumption of 'standard' products. Various theoretical hypotheses exist but not supported by robust evidence on consumers behaviour.

Overall, the relevant literature confirms there is an inverse relationship between the price and the consumption of alcoholic beverages;<sup>288</sup> additional studies have also demonstrated the significant positive relationship between alcohol consumption and health-related issues;<sup>289</sup> both relationships have been confirmed for young consumers.<sup>290</sup>

<sup>286</sup> Information and education campaigns are normally carried out in all MS, so they should not be considered alternative but rather complementary measures of tax-related measures.

<sup>287</sup> The latter view is relative more widespread among ethyl alcohol industry and non-industry respondents.

<sup>288</sup> See, for instance, Babor, T et al., 'Alcohol Policy and the Public Good', 1994.

<sup>289</sup> See Osterberg, E., 'Effects of price and taxation', 2001, in Heather, N., Peters, T.J. and Stockwell, T. (Eds) International Handbook of Alcohol Dependence and Problems, 685-698; Chaloupka, F.J., Grossman, M. and Saffer, H., 'The effects of price on alcohol consumption and alcohol-related problems', Alcohol Research & Health. 26(1):22-34, 2002; Babor, T. et al., 'Alcohol: No ordinary commodity – research and public policy', 2003.

Although this literature is crucial in understanding the link between prices of alcoholic beverages and per capita alcohol consumption, it does not allow to draw direct conclusions with regard to the public health impact of incentives for low-strength alcohol. In fact, the application of reduced rates to low-strength alcoholic beverages could influence consumers' behaviour in opposite ways, as follows:<sup>291</sup>

- First, consumers could switch to drinking low-strength alcohol without increasing their overall consumption (in litres) of alcoholic beverages. In this case, reduced rates could lead to a less harmful use of alcohol, as defined by the WHO.<sup>292</sup> This possible impact is also supported by considerations on the limited amount of liquid that can be ingested in one session, suggesting that low-strength products would likely be consumed in greater quantities.<sup>293</sup>
- Second, lower prices for low-strength alcohol may provide incentives to former abstainers (including adolescents) to start consuming alcoholic beverages. In a nutshell, if prices of low-strength alcoholic beverages decrease due to the application of reduced rates, consumers may substitute alcohol-free beverages for low-strength alcoholic drinks. Only few empirical studies provide data on drinking initiation patterns. For example, in a country with a high prevalence of abstainers, an increase in the taxation of alcoholic beverages may prevent drinking initiation among youth and decrease harm associated with the consumption of alcohol.<sup>294</sup> If such correlation appears to be true, its inverse may as well be: a decrease in the taxation of alcoholic beverages (whether of regular or low-strength) may result in higher drinking initiation.
- Finally, consumers opting for low-strength alcoholic beverages may increase their consumption of such products, with a neutral or negative impact on the pure alcohol intake. In practice, consumers may allow themselves to drink larger quantities of alcoholic beverages because of their lower ABV content. This evidently implies that consumers are aware of and pay attention to the alcohol content of their drinks, which is quite obvious in the case of products of different nature (e.g. between beer and spirits), but more difficult between drinks of the same category and for small ABV differences (e.g. beer of 3.5% vol *versus* beer of 5% vol), especially in the 'on-trade' consumption.<sup>295</sup>

The analysis of a literature case-study concerning the implementation of reduced rates for low-strength alcohol in Australia (see Box 16) shows that beneficial public health effects can be observed when incentives to switch to low-strength alcohol are combined with other education and alcohol control policies. Needless to say, the results achieved in

<sup>290</sup> Cook, P.J., Moore, M.J., 'The economics of alcohol abuse and alcohol-control policies', *Health Affairs*, 21(2):120-33, 2002; Chaloupka, F.J., et al. (2002); Markowitz, S., Chatterji, P., and Kaestner, R., 'Estimating the impact of alcohol policies on youth suicides', *Journal of Mental Health, Policy and Economics*, 6(1):37-46, 2003.

<sup>291</sup> These effects are registered in case reduced rates lead to lower prices for low-strength alcoholic beverages. Shemilt, I. et al., 'What do we know about the effects of exposure to 'Low alcohol' and equivalent product labelling on the amounts of alcohol, food and tobacco people select and consume? A systematic review', *BMC Public Health*, 2017; Rehm, J. et al., 'Evidence of reducing ethanol content in beverages to reduce harmful use of alcohol', *The Lancet Gastroenterology and Hepatology*, 1(1):78-83, 2016.

<sup>292</sup> The WHO offers both a broad and an operational definition of 'harmful use of alcohol'. The broad definition encompasses all drinking behaviours resulting in detrimental health and social consequences, not only for the consumer, but also for people surrounding the consumer, and society as a whole (WHO, 'Global strategy to reduce the harmful use of alcohol', 2010). The operational definition provides concrete indicators such as total alcohol consumption per capita within a calendar year in litres of pure alcohol, age-standardised prevalence of heavy episodic drinking among adolescents and adults, and alcohol-related morbidity and mortality among adolescents and adults (WHO, 'Global action plan for the prevention and control of NCDs 2013-2020', 2013).

<sup>293</sup> Shemilt, I. et al. (2017).

<sup>294</sup> Sornpaisarn B., et al., 'Can pricing deter adolescents and young adults from starting to drink: an analysis of the effect of alcohol taxation on drinking initiation among Thai adolescents and young adults', *J Epidemiol Glob Health*, 5: S45-57, 2015.

<sup>295</sup> Geller E.S., Kalsher M.J., Clarke S.W., 'Beer versus mixed-drink consumption at fraternity parties: a time and place for low-alcohol alternatives', *J Stud Alcohol*, 52: 197-204, 1991.

a specific context cannot be immediately generalised, since other factors - like cultural settings, consumption habits, price sensitivity, traditions, etc. – may play a role. In any case, as various stakeholders underline, public health effects relate to the pure alcohol intake and not so much to the ABV of specific beverages, so prevention campaigns and programmes unanimously play a more prominent role. However, policies aimed at reducing per capita consumptions could benefit from reduced rates, as a complementary measure, especially when standard taxation is not proportionate to the alcohol content.

**Box 16 – The impact of reduced rates for low-strength alcohol in Australia**

A case study on the health effects of low-strength alcoholic beverages could be based upon an example from Australia. In the Northern Territories of Australia, a reduction in the tax levied on low-strength alcoholic beverages led to an increase in the consumption of such products, which further led to a decrease in acute and chronic mortality.<sup>296</sup> This result reveals a positive relationship between reduced rates on low-strength alcohol and health benefits. Nevertheless, the observed positive public health effects may not only be attributed to the increased consumption of low-strength drinks. Indeed, the accommodating taxation policy implemented for low-strength alcoholic beverages was complemented by increased controls on alcohol availability, expanded treatment and rehabilitation services, as well as by changes in education.<sup>297</sup> In conclusion, beneficial health effects may only be observed when reduced rates are combined with other policies aiming to combat harmful use of alcohol. At national level, in 2000, Australia reduced duty rates by almost 50% for on-trade beer containing between 3.0% and 3.5% vol. This policy resulted in an increase in the market share for this segment by nearly 7% (up to 18%) in an overall declining market.<sup>298</sup>

To sum up, the net impact on public health of reduced rates applied to low-strength alcoholic beverages remains unclear, due to lack of detailed data on the drinking patterns for such products (sometimes also due to the novelty of such products). There is however general consensus across stakeholders of different MS that reduced rates, and taxation policy at large, is not sufficient to achieve public health policy targets; additional tools like information and education campaigns, limitations on advertising and selling options, etc. are also necessary.

#### 2.4.2 Problem analysis

The Directive includes provisions allowing for reduced rates on low-strength alcoholic beverages in all product categories, but it does not define targets and objectives for such provisions. This option has been used by a few MS for a mix of reasons: (i) tailor national taxation policies (e.g. introduce a certain proportionality with ABV strength for certain products); (ii) pursue objectives of industrial and agricultural policy; (iii) achieve health policy objectives, etc. The different rationale is deemed to be one of the main drivers behind the diverse implementation at MS level of such provisions. This issue has been highlighted also in the Ramboll Evaluation.<sup>299</sup>

The ultimate policy goal of these provisions remains unclear, but this is generally not perceived as an obstacle to its uptake in MS (as confirmed by in-depth interviews). On the opposite, the lack of a stated policy objective contributes to its adaptation and flexible use across MS in line with domestic needs and priorities.<sup>300</sup>

<sup>296</sup> Stockwell T et al., 'Consumption of different alcoholic beverages as predictors of local rates of night-time assault and acute alcohol-related morbidity', *Aust N Z J Public Health*, 22: 237–42, 1998; Chikritzhs T., Stockwell T., Pascal R., 'The impact of the Northern Territory's Living With Alcohol program, 1992–2002: revisiting the evaluation', *Addiction*, 100: 1625–36, 2005.

<sup>297</sup> Knai C et al., 'Are the public health responsibility deal alcohol pledges likely to improve public health? An evidence synthesis', *Addiction*, 110: 1232–46, 2015.

<sup>298</sup> Data collected by the Australian Bureau of Statistics.

<sup>299</sup> Ramboll Evaluation (2016).

<sup>300</sup> In addition, the diverse implementation at MS level has no impact on the functioning of the Internal Market as excise duty is charged where the product is released for consumption.

On the other hand, the Directive sets the alcoholic strength thresholds to apply reduced rates at levels that are largely irrelevant for some product categories. In this sense, the current thresholds may hinder the uptake of these provisions by certain MS and limit the magnitude of the effects possibly pursued. This raises the question of whether different thresholds would be more effective:

- With regard to beer the current threshold apparently applies only to radler and very few other products. In this sense, it does not provide a tangible incentive to produce/consume low-strength beer. Brewers from all sample MS would generally welcome an increase in the threshold for low-strength beer from 2.8% vol to 3.5% vol in order to capture a larger share of the demand and enhance the distinction with alcohol-free beer. In a similar fashion, there is a niche market for ale just below 3.5% vol.<sup>301</sup>
- In the same vein, the current thresholds for wine (8.5% vol), intermediate products (15% vol) and ethyl alcohol (10% vol), are generally much below the typical strength of these products, so only a few are currently covered. In many cases, to comply with product definitions spelled out by Union law, such products must have an alcohol content above the maximum thresholds set by the Directive. Therefore, in the current conditions, 'standard' products have generally no access to reduced rates, while 'special' products like mixed drinks and some flavoured/aromatised drinks do have. Whereas a revision of thresholds for these product categories may provide a more balanced access to the facility, there is no agreement among stakeholders on the need to change and the benefits (or drawbacks) that can be expected, as well as on alternate, more appropriate thresholds.
- Conversely, the threshold set for OFB (8.5% vol) covers almost the entire market for cider and perry and a portion of the market for fruit wine, so it can be flexibly used by MS to pursue their different policy priorities. While some stakeholders may argue that this threshold is even too high, it is worth recalling that MS are free to set the national threshold below the one spelled out in the Directive (e.g. 5.0% vol). Therefore, no policy problem is detected when it comes to OFB.

To sum up, the policy problem that is worth examining in this Study concerns the possible adoption of alternative, higher thresholds for low-strength products in order to allow a greater coverage of the market (except for OFB, where the threshold is sufficiently high). In the analysis, we maintain beer separated from other category of products, due to the different level of demand (and agreements) among stakeholders for redressing solutions.

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<sup>301</sup> For instance, sessions real ales.

➤ **SUMMARY OF PROBLEM ANALYSIS**

<b>Problem drivers</b>	<b>Adverse effects</b>	<b>Expected evolution</b>
<b>Too low ABV threshold for low-strength beer, only covering a small share of the market</b>	<ul style="list-style-type: none"> <li>• The current threshold is not relevant as there is no true market for low-strength beer with the exception of radler and few other products</li> <li>• No real incentive to produce/consume low-strength beer</li> </ul>	<ul style="list-style-type: none"> <li>• Large beer producers are currently launching new beer with alcohol strength of 3.5% vol.</li> <li>• The uptake by MS of the provisions on reduced rates for low-strength beer may remain limited</li> </ul>
<b>Too low ABV thresholds for low-strength wine, intermediate products and ethyl alcohol, only covering a small share of the market</b>	<ul style="list-style-type: none"> <li>• The current thresholds are not relevant as most of wine, intermediate products and spirits must have an actual alcoholic strength by volume higher than the thresholds set by the Directive</li> <li>• The provision may eventually incentivise 'special' products against 'traditional' ones.</li> </ul>	<ul style="list-style-type: none"> <li>• The uptake by MS of the provisions on reduced rates for low-strength wine, intermediate products and especially spirits may remain limited</li> </ul>

## 2.5 Exemptions for private production

In this Section, the problem definition concerning the exemption for private production for own consumption is presented. The analysis focuses on the six MS in which fieldwork activities were carried out for this issue (the sample MS): Austria, Finland, Italy, Poland, Romania and the United Kingdom. In Section 2.5.1, the baseline assessment is reported, analysing the national legal frameworks first, and then estimating the amount of home distillation in each of the sample MS. Then, in Section 2.5.2, the problem analysis is carried out, describing the nature and magnitude of the issue at stake, including its likely development.

### 2.5.1 Baseline assessment

Directive 92/83/EEC gives MS the option of exempting private production of fermented beverages for own consumption from excise duties, provided that no sale is involved. The exemption can be applied to beer,<sup>302</sup> wine,<sup>303</sup> and other fermented beverages.<sup>304</sup> Conversely, an exemption to private production for own consumption is not provided for the remaining categories, namely ethyl alcohol and intermediate products.<sup>305</sup>

The rationale why private production of ethyl alcohol is not granted a duty exemption in the Directive can be traced back to both health and tax reasons. The category of ethyl alcohol consists mostly of distilled products.<sup>306</sup> Distillation is, from a health perspective, more dangerous than fermentation, due to the possibility of mistakenly producing beverages with an excessive level of methanol.<sup>307</sup> Moreover, given the higher EU minimum and national excise duty rates imposed on ethyl alcohol, the risk of tax fraud is higher than for the other beverages. The higher health risks linked with private distillation would also explain the concomitant exclusion from the scope of the exemption of intermediate products: indeed, this category includes beverages which can contain distilled alcohol (e.g. fortified wine).<sup>308</sup> Given the reconstructed rationale, the analysis in this Section will distinguish between fermented beverages, on one side, and distilled alcohol on the other.

The regulatory framework for private production for own consumption in the sample MS is largely homogeneous. The private production of fermented beverages for own consumption, including beer, wine, fruit-wine, cider, and other fermented beverages is allowed and exempted from duties in all these MS.<sup>309</sup> On the contrary, private distillation is not allowed in four out of the six countries – Finland, Italy, Poland, and the UK – but it

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<sup>302</sup> Article 6.

<sup>303</sup> Article 10.

<sup>304</sup> Article 14.

<sup>305</sup> Based on Article 22.6 and 22.7 the production of ethyl alcohol can be subject to lower excise duties when distilled in fruit growers' distilleries from fruit supplied by fruit growers' households. This option is granted to BG, CZ, HU, RO, and SK.

<sup>306</sup> Namely, spirits, liqueurs, and other spirituous beverages. Hereinafter, 'spirits'. Fermented beverages with an ABV strength higher than 22% are also classified as ethyl alcohol.

<sup>307</sup> See Stakeholder interviews; Huckenbeck W., Freudenstein P., Jeszenszky E. and H.G. Scheil, 'Congeners in spirits produced by moonshine distillers', *Blutalkohol* Vol. 40, pp. 294-301, 2003; Rehm, J., Kailasapillai, S., Larsen, E., Rehm, M.X., Samokhvalov, A.V., Shield, K.D., Roerecke, M. and D.W. Lachenmeier, 'A systematic review of the epidemiology of unrecorded alcohol consumption and the chemical composition of unrecorded alcohol', in *Addiction*, 109, pp. 880-893, 2014.

<sup>308</sup> The intermediate product category also includes beverages whose alcohol is entirely of fermented origin.

<sup>309</sup> Small differences exist in the applicable regime: for example, in Austria the excise legislation only applies to commercial producers, thus completely exempting private producers from any requirement spelled out therein. In the UK, commercial licensed producers of wine and other fermented beverages are allowed an exemption for private production, but licensed breweries do not enjoy the same exemption. In Italy, there is no explicit exemption for the private production of wine, but it results from the joint application of a zero rate and of the simplification for production, warehousing, movement, and controls granted to small producers.

is possible in Austria and Romania. In the former country, private distillation can be duty free, while in the latter it is taxed at a reduced rate (see Box 17 below). Though not explicitly allowed, these provisions reportedly find their justification in the minute statements of the Ecofin Council that adopted the Directive, stating that MS were allowed to maintain 'traditional exemptions' for the private production of any alcoholic beverage.<sup>310</sup>

**Box 17 - Private distillation in Austria and Romania**

In Austria, duty-free production of spirits is allowed under the *Hausbrand unter Abfindung* regime.<sup>311</sup> When a farmer is running an *Abfindung* (flat-rate) distillery, that is a small agricultural distillery, he/she is allowed not to pay excises on up to 15 litres of pure alcohol (lpa) per year, a quantity which is considered for private consumption of the family. The exemption can reach up to 27 lpa alcohol per household, depending on the number of family members, and up to 51 lpa in Tyrol and Vorarlberg. Only farmers – meaning those (i) running an agricultural or forestry business; (ii) living on the premises of this business; and (iii) earning a significant amount of his/her living from this business – running an *Abfindung* distillery can obtain the *Hausbrand* exemption. Other individuals running an *Abfindung* distillery cannot apply for it. Exempted production needs to be declared to the customs authorities and can be sold, in line with the rules of the *Abfindung* regime. This exemption dates back to 1830s and both public authorities and economic operators consider it to be necessary to protect the production of traditional spirits. The Commission opened an infringement procedure on this exemption on February 2017, by sending the Austrian government a letter of formal notice (ex Article 258 TFEU), which could eventually lead to challenging the *Hausbrand* regime before the CJEU.<sup>312</sup> The Austrian government formally replied in July, rejecting the claims.<sup>313</sup>

In Romania, private production of *tuica* (plum brandy) and *rachiurile de fructe* (fruit brandy) up to 0.5 hlpa per year per household is allowed, but it is not duty free. It is taxed at a reduced rate, fixed at 50% of the standard rate. This exception seems to be similar to what is granted by Article 22.7; however, any citizen, and not only fruit growers, could be granted the reduction, and distillation needs not to take place in fruit growers' distilleries. Private producers need to notify customs of their distillery equipment (one-off notification), and of the quantity produced every year.

Private production of fermented beverages is largely a non-regulated activity. In most of the sample MS, private producers of e.g. beer or wine need not to register or undergo any administrative procedure,<sup>314</sup> and they are subject to no monitoring or controls. Judicial cases concerning illicit private production of fermented beverages, for example duty-free products for own consumption that were eventually put up for sale, were hardly reported by public authorities, as this issue is considered to be a very low enforcement priority.<sup>315</sup> Indeed, customs authorities have neither the means to extensively control a myriad of private producers of fermented beverages, nor the interest to recover potential foregone revenues which, in their opinion, are not substantial enough.

In line with the unregulated nature of this activity, the number of private producers and the quantity produced are not tracked, and no official data could be retrieved. A qualitative assessment was thus sought. Based on authorities' and economic operators' feedback, private production of wine appears to be common in wine-producing countries, such as Italy and Romania. Home brewing is becoming more popular, sometimes

<sup>310</sup> This emerged from the interviews and the consultation of secondary sources, namely: Fiscalis Project Group, 'Discussion document on the provisions regarding small and medium sized enterprises (SME) involved in the production of alcohol and alcoholic beverages for excise duty purposes', Fiscalis seminar in Sopot, Poland, 14–16.10.2008, at p. 17. A copy of the minutes of the Ecofin Council could not be retrieved from public archives.

<sup>311</sup> See Section 2.3.2.

<sup>312</sup> European Commission, Infringement Decision Database, accessed on September 2017.

<sup>313</sup> News.at, 'EU hat Österreichs Schnapsbrenner im Visier', 25.08.2017, available at: <https://www.news.at/a/wirtschaft-eu-oesterreichs-schnapsbrenner-visier-8278290> (last accessed on September 2017).

<sup>314</sup> An exception is Romania, where home-winemakers need to register.

<sup>315</sup> Cases of sales of home-produced beer were reported to have happened in the last decade by a stakeholder in Poland.

extensively so, in all the countries visited, both in MS in which this was a longstanding tradition, such as the UK, and in MS where this phenomenon emerged in the last decade, such as Poland and Italy. Home-production of other fermented beverages, such as cider or fruit-wine, exists and is linked to local demand and production traditions, but it is less common than wine and beer production.<sup>316</sup>

With respect to home distillation, its spread varies from MS to MS:

- In the UK and Finland, public authorities, economic operators, and health stakeholders consider it to be a minor to negligible phenomenon. Even though instances of illicit home distillation were reported, they are occasional and mostly limited to rural areas, where private individuals may have access to their own agricultural raw materials.
- In several regions of Italy and Poland, home distillation is part of the local agricultural tradition. In Italy, home distillation is not considered to pose significant problems and it is not among the enforcement priorities for customs authorities. Though hard data on producers and production are not available, in Poland stakeholders estimate that home distillation may represent less than 10% of the illicit alcohol market, which largely consists of surrogate products obtained from denatured alcohol. Hence, even though episodes of illicit home production are reported by Polish authorities, the focus of the fight against illicit alcohol remains largely on purification rather than home distillation.
- In Austria and Romania, where private distillation is allowed, the situation is quite different. In the former MS, it is widespread (the number of private distillers is gauged to be in the order of 30,000-40,000 individuals). The very large part of private distillation takes place under the *Hausbrand* exemption, and it is therefore legal. In the latter MS, private distillation is authorised and taxed, although at a reduced rate. However, part of the private production falls outside the excise system, and is thus to be considered illegal. Industry estimates<sup>317</sup> indicate that illicit home distillation represents a small portion of the illicit spirit market, at about 10%.

Given the lack of direct sources, an indirect methodology is resorted to estimate illicit home distillation. This methodology combines available information on unrecorded alcohol, collected by the WHO,<sup>318</sup> and the qualitative and quantitative assessment collected from public authorities, health and economic operators in the countries visited, as well as from the health literature on alcohol control.

Unrecorded alcohol is defined as '*alcohol which is not taxed and is outside the usual system of governmental control*'.<sup>319</sup> It includes both licit and illicit alcohol, and namely the following categories:

- Home production, both licit and illicit;
- Small- or large-scale clandestine production;
- Cross-border shopping (alcohol 'recorded' in another jurisdiction);<sup>320</sup>
- Smuggling, i.e. illegal trade of alcoholic beverages;

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<sup>316</sup> In the UK, home production of made-wine, i.e. from fruits, traditionally exists, and is exempted from the excise duty. In Finland, private production of fruit wine became popular in the 90s, but this trend has largely disappeared.

<sup>317</sup> Confidential data, on file with the authors.

<sup>318</sup> WHO, 'Global status report on alcohol and health', 2014. Latest available data refer to 2010.

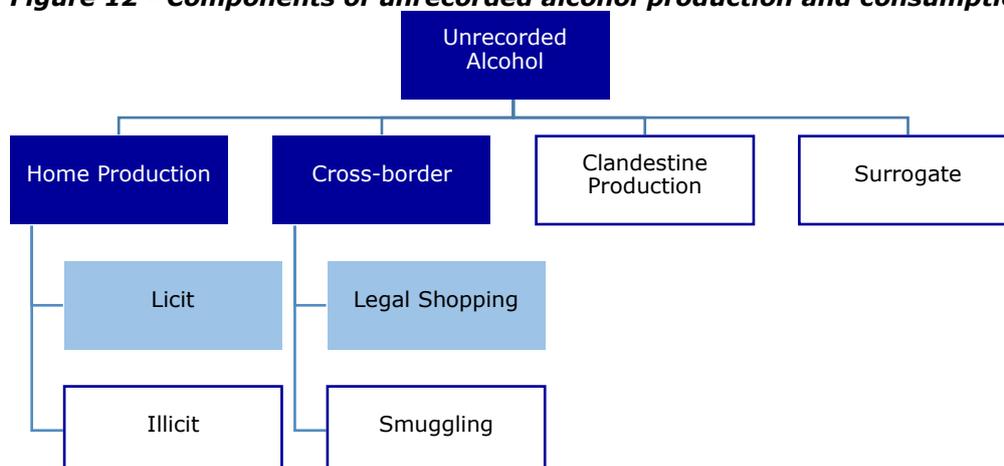
<sup>319</sup> Ibid, p.364.

<sup>320</sup> 'Cross-border shopping' is licit for small amount of products for personal use (regulated by Article 32 of Directive 2008/118/EC. However, the disparities in price levels between bordering countries may also provide incentives for more frequent and sizeable cross-border flows of 'recorded' alcohol operated by individual citizens, for private consumption or small-scale informal business (also known as 'bootlegging').

- Surrogate alcohol, that is alcoholic beverages obtained from the purification of denatured alcohol.

The various components of unrecorded alcohol are shown in Figure 12; licit components are identified in light blue, and illicit ones in white. Estimates of unrecorded alcohol in the six countries visited are reported in Table 41.

**Figure 12 - Components of unrecorded alcohol production and consumption**



**Legend:** in light blue, licit components, in white, illicit components.  
**Source:** Author's elaboration, based on WHO (2014).

**Table 41 - Unrecorded alcohol consumption in sample MS**

	Unrecorded alcohol	Total alcohol consumption	Share of unrecorded alcohol
	lpa per capita		%
Austria	0.6	10.3	6%
Finland	2.3	12.3	19%
Italy	0.2	6.7	3%
Poland	1.6	12.5	13%
Romania	4	14.4	28%
United Kingdom	1.2	11.6	10%

**Note:** lpa: litres of pure alcohol.  
**Source:** WHO (2014).

**Box 18 - Data on unrecorded alcohol consumption**

Though unrecorded alcohol represents an important share of alcohol consumption, the quality of data concerning this phenomenon is far from being excellent. An estimation of unrecorded alcohol consumption is done by WHO based on different sources and methodologies. Among possible sources, preference is given to national government statistics (including survey-based); then, to industry statistics and databases; finally, to the Food and Agriculture Organisation of the United Nations' statistical database. With respect to the validity of surveys on alcohol consumption, they can suffer from underreporting, due to social stigma, and their results tend not to be unequivocal. Furthermore, in some cases, even though indicators on alcohol consumption are designed to test the correlation with alcohol-related diseases, data on unrecorded alcohol are estimated based on the health impacts of alcohol consumption, which may create problems of reverse inference.<sup>321</sup>

<sup>321</sup> See also Rehm J., Kanteres F, and D.W. Lachenemeieri, 'Unrecorded consumption, quality of alcohol and health consequences', in Drug and Alcohol Review, Vol. 29, pp. 426-436, 2010.

Based on the data on unrecorded alcohol presented above, it is then necessary to identify the following parameters:

1. the share of home production over unrecorded alcohol; and
2. the share of illicit home distillation over home production.

Quantitative estimates of these parameters are available for Romania, based on an industry evaluation.<sup>322</sup> For the other 5 sample MS, the two parameters are estimated based on a five-ladder qualitative scale as described in Table 42 below.<sup>323</sup>

**Table 42 - Parameters for the estimation of illicit home distillation in the sample MS**

MS	Relevance of home production over unrecorded alcohol		Relevance of illicit home distillation over home production	
<b>Austria</b>	Medium-low	As in other north-western European countries, a large part of unrecorded alcohol is estimated to consist of cross-border shopping (Leifman, 2001). However, compared to FI and UK, AT is a wine-producing country and has a significant legal home-production of spirits.	Low	Most of home distillation is licit under <i>Hausbrand</i> .
<b>Finland</b>	Low	High-price country compared to neighbours. Cross-border shopping, possibly including 'bootlegging', represents the largest single component (Rehm <i>et al.</i> , 2010, Lachenmeier <i>et al.</i> , 2011), at about 62% of the unrecorded alcohol consumption (2015 data from WHO and National Institute for Health and Welfare). Even among the other components, home production is considered of limited importance.	Low	Home distillation is very sporadic. Only 4% of Finnish consumers reported to have consumed illicit spirits over the last year (source: industry survey).
<b>Italy</b>	Medium	Substantial volume of unrecorded alcohol from home production is typical for Mediterranean countries (Leifman, 2001).	Medium-low	Home production of wine predominant. Traditional production of spirits exists in certain regions. Share of Italian citizens having drunk home-distilled spirits estimated at 26% (Leifman, 2001).
<b>Poland</b>	Low	Stakeholders estimate that home production represents less than 10% of the market for illicit alcohol. This is in line with the health literature, which considers surrogate alcohol more prominent (Rehm <i>et al.</i> , 2010, Lachenmeier <i>et al.</i> , 2011).	Medium-high	Private distillation likely to represent a significant part of home production (Lachenmeier <i>et al.</i> , 2009), because (i) negligible wine production; (ii) high share of spirit consumption over total alcohol consumption (RAHRA, 2017)
<b>United Kingdom</b>	Low	High-price country compared to neighbours. Most of unrecorded alcohol likely to be cross-border shopping. (Leifman, 2001, Rehm <i>et al.</i> , 2014). The only significant home production is home brewing – limited private production of wine, cider, made-wine and spirits.	Low	Home distillation is very sporadic, according to public authorities and economic operators. Share of British citizen having drunk home-distilled spirits estimated at 5% (Leifman, 2001).

**Source:** Author's analysis, based on various sources.<sup>324</sup>

<sup>322</sup> Confidential data, on file with the author.

<sup>323</sup> The qualitative assessment is transformed into the following quantitative factors: low: 10%; medium-low: 25%; medium; 50%; medium-high: 75%; high: 90%.

<sup>324</sup> Sources quoted in the table: Rehm J., Kanteres F, and D.W. Lachenmeieri, 'Unrecorded consumption, quality of alcohol and health consequences', in Drug and Alcoholic Review, Vol. 29, pp. 426-436, 2010; Leifan

Based on the assessment described above, the amount of illicit distillation estimated for the sample MS is reported in the Table 43 below. The main finding is that, in most MS, illicit home distillation represents a negligible part of the spirit market: below or around 1% in Austria, Finland and the United Kingdom, and slightly higher (about 2.5%) in the case of Italy, where a local tradition exists. The share is higher in Poland, where it reaches 3.5% of the market, and, most notably, in Romania. This finding is in line with the qualitative evidence provided by local stakeholders (Box 15). Extrapolating results at EU level, home distillation is estimated at about 210,000 hlpa, or 2.3% of the spirit market (based on the share of unrecorded alcohol of the sample MS over the EU total, that is 40%). These results are also in consonance with those provided by OPC respondents, where 41% of the respondents considered that the spread of private distillation is 'nihil' or 'small', and 43% that it is 'modest'; only 15% considered it as significant.

**Table 43 - Estimated illicit home distillation in the sample MS**

	Home distillation	Spirit Market	Share of the spirit market
	hlpa	hlpa	%
Austria	1,103	111,627	1.0%
Finland	1,052	94,626	1.1%
Italy	13,103	502,901	2.6%
Poland	38,749	1,098,450	3.5%
Romania	25,119	424,188	5.9%
United Kingdom	6,409	1,153,897	0.6%
<b>Total</b>	<b>85,535</b>	<b>3,385,689</b>	<b>2.5%</b>
<b>EU</b>	<b>213,838</b>	<b>9,361,724</b>	<b>2.3%</b>

*Source: Author's analysis; IWSR data.<sup>325</sup>*

## 2.5.2 Problem analysis

### 2.5.2.1 The nature of the problem: fermented beverages

All stakeholders consulted and available sources analysed suggest that the private production of fermented beverages does not create any significant problem, either economic or regulatory,<sup>326</sup> over the various categories of impacts relevant to the analysis. This is in line with the findings provided in the Commission Evaluation:

- With respect to market effects and tax revenues, impacts of home production of fermented beverages proved to be minimum. More in detail:
  - Although private production of wine is common in producing countries, market operators and public authorities do not see any concern, especially given that, in the MS representing 98% of the EU production, wine is taxed at zero or

H., 'Estimations of unrecorded alcohol consumption levels and trends in 14 European countries', in Nordisk Alkohol- & Narkotikatidskrift, Vol. 18, 2001; Lachenmeier, D.W., Ganss, S., Rychlak, B., Rehm, J., Sulkowska, U., Skiba, M. and W. Zatons, 'Association Between Quality of Cheap and Unrecorded Alcohol Products and Public Health Consequences in Poland', in Alcoholism: Clinical and Experimental Research Vol. 33, No. 10, 2009; Lachenmeier, D.W., Schoeberl, K., Kanteres, F., Kuballa, T., Sohnius, E.M. and Rehm, J., 'Is contaminated unrecorded alcohol a health problem in the European Union? A review of existing and methodological outline for future studies', in Addiction, Vol. 106, 2011; RAHRA, 'Comparative monitoring of alcohol epidemiology across the EU', 2017; Rehm, J. Kailasapillai, S., Larsen, E., Rehm, M.X., Samokhvalov, A.V., Shield, K.D., Roerecke, M. and D.W. Lachenmeier, 'A systematic review of the epidemiology of unrecorded alcohol consumption and the chemical composition of unrecorded alcohol', in Addiction, 109, pp. 880-893, 2014.

<sup>325</sup> The conversion between hl of products and hlpa is done assuming 40% vol.

<sup>326</sup> At p 15. See also Ramboll Evaluation, at p. 42.

near-zero<sup>327</sup> rate. Hence, even if a certain quantity of home-produced wine was put up for sale, it would enjoy (almost) no excise advantage and would then create no competition threats to legal operators; moreover, foregone excise revenues would be negligible.

- Public authorities reported no cases in which home brewing was linked to tax frauds. In addition, the beer industry, in all sample MS, considers that home brewing poses no competitive constraints. There are no indications of an unfair competition arising from duty-free home beer put up for sale. In particular, this threat is considered implausible, as it would be extremely difficult for home producers to brew beer in sufficient quantity and, most importantly, of a sufficient and stable quality, to regularly supply even an informal market. To the contrary, the growth of home brewing is considered conducive to the beer culture, resulting in a higher popularity of beer on the beverage market. *A fortiori*, no cross-border impact could be identified.
- Administrative costs related to private production of fermented beverages are negligible. Such activity is largely unregulated and unmonitored in the sample MS, and only a few exceptions could be identified.<sup>328</sup> The bulk of private producers undergo no administrative procedures at all.
- Enforcement costs for public authorities are also negligible. Systematic controls and monitoring systems are not put in place, given that private production of fermented beverages remains a low priority for customs authorities. Moreover, instances of illegality in this area were reported as sporadic. Hence, no dedicated or additional enforcement resources are spent by customs authorities in this area.
- With respect to health consequences, private production of fermented beverages has not been associated to risks in terms of (i) quality of the product; or (i) hazardous alcohol consumption patterns. With respect to per capita alcohol consumption, the primary harm from unrecorded alcohol, including home production, arises from the fact that it is typically much more accessible than recorded alcohol.<sup>329</sup>
- Public authorities also report that home production is not connected to criminal activities, which mostly focus on clandestine distillation and production of surrogate beverages from denatured alcohol.

### 2.5.2.2 The nature and magnitude of the problem: private distillation

In its Conclusions, the Council *'invites the Commission to investigate further the potential impact of allowing Member States to exempt from excise duties the production of ethyl alcohol and intermediate product for own consumption'*, while at the same recalling *'the particular importance of striking the right balance between revenue, the costs of tax administration, other aspects relating to consumption and the impact on cross-border trade.'*<sup>330</sup> Accordingly, the problem at stake is framed in terms of unequal treatment of the fermented and distilled beverages, subject to verification of whether

<sup>327</sup> This is the case of France, where the excise duty on wine is set at 3.77 €/hl; as a comparison, the unweighted average of the positive excise duty rates in the EU is 139.81 €/hl.

<sup>328</sup> E.g. the duty of registration for home-winemakers in Romania, or the limited information to be provided in the context of filling excise tax return to use the allowance for private production of wine and cider by licensed producers in the UK.

<sup>329</sup> Rehm, J. Kailasapillai, S., Larsen, E., Rehm, M.X., Samokhvalov, A.V., Shield, K.D., Roerecke, M. and D.W. Lachenmeier, 'A systematic review of the epidemiology of unrecorded alcohol consumption and the chemical composition of unrecorded alcohol', in *Addiction*, 109, pp. 880-893, 2014.

<sup>330</sup> Council Conclusions, at §9.

such an equal treatment could create excessive negative impacts. Here below, the assessment of the baseline situation along this mandate follows.

- The estimated level of private distillation results in the loss of tax revenues, the magnitude of which is quantified in Table 44.<sup>331</sup> Tax losses depend on both (i) the amount of illicit home production identified; and (ii) the applicable tax rate. In the 6 countries considered, lost excises reach about EUR 100 mn in total, or 1.4% of the excise revenues from ethyl alcohol. In 5 out of the 6 sample MS – except Romania – foregone revenues remain below 5% of the current revenues from ethyl alcohol. Only in Romania, where the issue has a higher magnitude, excise revenue losses are at almost 10% of the current revenues. Extrapolating results at EU level (based on the share of unrecorded alcohol in the sample MS), lost excises are estimated at about EUR 250 mn, or 1.6% of the excise revenues from ethyl alcohol.

**Table 44 – Estimated foregone excise duty revenue due to illicit home distillation**

	Home Distillation	Excise Duty Rate*	Foregone Revenues	Excise Duty from Ethyl Alcohol	% of Foregone Revenues
	hlpa	€/hlpa	€ '000	€ '000	%
Austria	1,103	648	715	120,400	0.6%
Finland	1,052	4,555	4,793	413,580	1.2%
Italy	13,103	1,036	13,569	634,860	2.1%
Poland	38,749	1,343	51,481	1,658,640	3.1%
Romania	25,119	374	9,332	101,720	9.2%
United Kingdom	6,409	3,755	20,303	4,225,710	0.5%
<b>Total</b>	<b>85,535</b>	-	<b>100,193</b>	<b>7,154,910</b>	<b>1.4%</b>
<b>EU</b>	<b>212,264</b>	-	<b>248,638</b>	<b>15,478,502</b>	<b>1.6%</b>

**Source:** EDT and Author's analysis on WHO, IWSR, findings from the interviews and desk research.

**Note:** (\*) fore AT and RO the reduced rates for small producers are considered; data refer to 2015.

- The intensity of negative market effects is proportional to the magnitude of the phenomenon, and, thus, is uneven across countries. Stakeholders operating where illicit home distillation has a negligible or limited occurrence, such as in Austria, Finland, Italy and the United Kingdom, report no problems in terms of unfair competition. In these countries, the views of economic operators and those of trade associations are therefore aligned with that of public authorities in considering private distillation a low enforcement priority. With respect to Poland, stakeholders do have concerns with competition threats from illicit alcohol; however, home distillation is considered a significantly smaller threat than surrogate alcohol, also because the latter is cheaper to produce, and can thus more seriously undercut the price of licit products. Market impacts become relevant in Romania, given that illicit home distillation is estimated to represent 6% of the spirit market.
- Though market effects are not negligible in certain MS, in none of the visited countries problems with respect to cross-border flows of home-distilled alcohol could be identified. Home-distilled products were considered as having a very local circulation. Problems deriving from cross-border unrecorded alcohol, including licit (or 'bordeline') forms such as cross-border shopping,<sup>332</sup> and illicit ones, such as purification of PDA or CDA moved from another MS,<sup>333</sup> were

<sup>331</sup> Quantification is based on the assumption that private distillation is used to produce spirits, rather than intermediate products, and taxed accordingly. This is in line with the information collected from stakeholders on the types of beverages most commonly distilled at home. When reduced rates for small producers are available in a country, these are used for quantification, as private distillation is assumed to remain below the allowed maximum output.

<sup>332</sup> As in FI and the UK.

<sup>333</sup> As in PL.

discussed with public authorities and stakeholders; reportedly, cross-border home-distilled products do not represent a significant threat.

- Currently, there is no evidence from the fieldwork that private distillation is absorbing significant enforcement resources from public authorities, for various reasons. First, as discussed above, private distillation, even in countries where it is significant, is considered to be a limited threat to public revenues, both in absolute value and in comparison with other tax frauds and types of illicit alcohol. Secondly, given the dispersed nature of private distillation, the enforcement of this prohibition would require chasing a large number of individuals, each of them producing a limited quantity, so that the magnitude of the risk does not justify the commitment of significant resources.
- Home distillers potentially face large administrative burdens. Indeed, in the countries where home distillation is prohibited, distillation can only take place in a licensed distillery. This requires, at a minimum, (i) obtaining an authorisation from the (local) customs authority; and (ii) setting up and managing a tax warehouse.<sup>334</sup> For this reason, it has been underlined by public authorities and stakeholders that all private distillers do not attempt to comply with the applicable regulatory framework, and thus that no administrative costs or burdens arise.<sup>335</sup> The situation is different in Austria and Romania, where private distillers need to comply with a tailored set of administrative obligations, described in Box 19.

**Box 19 - Administrative costs and burdens for private distillation in Romania and Austria**

In Austria, licit private distillation takes place under the *Hausbrand unter Abfindung* regime. The private distiller needs (i) to prove that he/she is a farmer, and this is done in the context of the access to the common agricultural policy support, thus creating no additional burdens; and (ii) to deduct the excises due on the first 15 to 51 hlpa produced, depending on the size of his/her household and on his/her region of residence, from the duty payment. As such, accessing the *Hausbrand* exemption triggers no or negligible additional burdens for the private distiller.

In Romania, each person intending to distil spirits at home must notify the customs of the equipment at his/her disposal (one-off notification) and of the quantity of alcohol produced (yearly registration). The procedures are mostly carried out in paper and by visiting local customs office. Compliance with the framework thus generates modest administrative burdens for individuals.

Negative impacts from home distillation are considered to be limited, when singled out of the general health impacts linked to the consumption of distilled products. In particular, home distillation is not associated with hazardous consumption patterns. The main additional health risk of private distillation, compared to the consumption of commercial spirits, is methanol intoxication. In a proper distillation process, most of the methanol is removed from the final product; however, if distillation is done incorrectly, excessive amounts of methanol may end up in the spirit. That said, most of the clusters of methanol intoxications reported in Europe are linked to surrogate alcohol or adulterated beverages.<sup>336</sup> Italy reported one death due to methanol intoxication from private

<sup>334</sup> In the UK, a stakeholder reported that 'legal home distillation is possible, but the individual would need to get a license, set up a tax warehouse, demonstrate to be a 'fit and proper person', prepare a viable business plan, comply with recordkeeping duties, and calculate and pay the excise. Hence, even though there is not an explicit prohibition, in practice there is none to very little legal home distillation'.

<sup>335</sup> See Ramboll Evaluation, at p. 75.

<sup>336</sup> Even in countries such as Poland and Romania, where the magnitude of the phenomenon is larger (based on interviews with health institutions or NGOs in these countries).

distillation in 2014, while Finland reported none over the recent years.<sup>337</sup> With respect to per capita alcohol consumption, as in the case of fermented beverages, the primary harm from unrecorded alcohol, including home production, arises from the fact that it is typically much more accessible than recorded alcohol.<sup>338</sup>

- Finally, home distillation is not considered to be connected to criminal activities. Based on primary information retrieved from public authorities and economic operators, criminal activities in the field of illicit alcohol production mostly resort to larger scale processes, such as production of surrogate alcohol via purification techniques or larger-scale clandestine distillation.

The assessment of the magnitude of the problem, in quantitative terms where possible, and of its impacts across the various dimensions considered, is summarised in Table 45.

**Table 45 - Baseline assessment of the impacts linked to home distillation**

	Baseline Assessment
<b>Magnitude of the problem</b>	Negligible to limited in AT, FI, IT and the UK, at 1-3% of the licit spirit market. Modest in PL (39,000 hlpa, or about 3.5% of the licit spirit market); more significant in RO (25,000 hlpa, or about 6% of the licit spirit market)
	<b>Impacts on the baseline scenario</b>
<b>Tax revenues</b>	The magnitude of impact ranges between a few millions and some tens of millions EUR in each of the sample MS. In Romania, the estimated tax losses may amount to ca. 10% of the total revenues from ethyl alcohol.
<b>Market effects (including cross-border)</b>	No or very limited market effects were reported in AT, FI, IT and the UK; modest in PL, and less important than those linked to surrogate alcohol. On the contrary, in RO illicit home production is a competitive threat for legal operators. No cross-border impacts due to private-distilled beverages could be identified in the sample MS.
<b>Enforcement costs</b>	Private distillation currently does not absorb significant resources from customs authorities, which consider it either a negligible issue (in AT, FI, IT or the UK), and/or a lower priority compared to other challenges.
<b>Administrative burdens</b>	In MS where home distillation is prohibited (AT, FI, IT and PL), the burdens for private distillers are theoretically very high, so that in practice no private distiller complies with the administrative requirements. In AT and RO, the burdens are negligible to low.
<b>Health impacts</b>	Possibly higher per capita alcohol consumption and related harm due to increased accessibility. Higher risk of methanol intoxication from privately-distilled products compared to commercial beverages, but very limited adverse events in the sample MS.
<b>Crime</b>	Private distillation has not been associated to criminal activities. This impact category appears irrelevant and will not be further considered in the analysis.

### 2.5.2.3 Dynamic baseline scenario

Two main trends will determine the likely evolution of home production in general and of private distillation in particular.

- General trends in alcohol consumption. WHO data include projections up to 2025 for total alcohol consumption, which, in the 6 sample MS, is estimated to decline by 5% in total, the only two countries on the rise being Finland and the UK.

<sup>337</sup> Interviews with stakeholders.

<sup>338</sup> See Rehm J., et al. (2010).

- (ii) Specific trends in home production of the different beverages. Home brewing is on the rise in all sample MS and, based on the stakeholders views, at the moment there is no sign of deterioration of this tendency. Production of wine for own consumption is considered stable over the last decades.<sup>339</sup> Private distillation is judged to be in decline in most of the sample MS (with the possible exception of Romania), due to a combination of factors, such as (i) the lower number of people living in rural areas where raw materials are available, (ii) changes in the consumers' lifestyle and preferences, (iii) increase in the disposable income (allowing consumers to access more expensive and better quality licit alcohol); and (iv) loss of traditional production methods and techniques because of the existing prohibition.

The combination of the decline in total alcohol consumption and of the downward drivers examined above is likely to determine a reduction of the diffusion of home distillation, both in terms of the number of private distillers and the quantity produced.

As far as the political stance of MS authorities is concerned, policy changes are not foreseeable at national level. MS in which private distillation is not allowed maintain that the situation should not change for two reasons. First, and most importantly, the health risks associated with methanol poisoning and the possible increase in the consumption of spirits due to the liberalisation of private distillation (even from a symbolic point of view). Secondly, even though private distillation is not, in most MS, a risk per se to the integrity of public budgets, ethyl alcohol products present a higher risk of tax frauds, and hence their production should be more strictly controlled, as it is the case with the current regime. MS in which private distillation is allowed consider the current regimes as fundamental to preserve their rural traditions, and also that any prohibition would be unlikely to alter current practices (i.e. that it would be very difficult to enforce).

➤ **SUMMARY OF PROBLEM ANALYSIS**

Problem drivers	Adverse Effects	Expected evolution
<b>Unequal treatment of private production of alcoholic beverages</b>	<ul style="list-style-type: none"> <li>While home production of fermented beverages is possible, duty-free, and does not create significant adverse effects, home distillation is currently prohibited in most of MS.</li> </ul>	<ul style="list-style-type: none"> <li>Decline of private distillation, because of reduction of total alcohol consumption and disappearance of traditional productions.</li> <li>No changes in MS' attitude.</li> </ul>

<sup>339</sup> See Leifan H., (2001).

## 2.6 Measurement of Plato degree for sweetened/flavoured beer

Article 2 of the Directive defines 'beer' as 'any product falling within CN code 2203<sup>340</sup> or any product containing a mixture of beer with non-alcoholic drinks falling within CN code 2206, in either case with an actual alcoholic strength by volume exceeding 0.5% vol'. Article 3(1) of the Directive allows for levying excise duty on beer with reference either to the Plato degree or actual alcoholic strength by volume (ABV) of the 'finished product'. This Article results in different interpretations when it comes to measuring the Plato degree of sweetened/flavoured beer, i.e. mixture of beer with non-alcoholic additives or drinks. Different interpretations may lead to substantial differences in the excise duty applied and, in turn, in retail prices and consumption of such product.

This Section provides a baseline assessment of the issue by analysing the concerned product, assessing the features and size of the relevant market, discussing the existing approaches to measuring the Plato degree and estimating tax revenues generated by this type of product. Finally, we review the main policy problems stemming from the different approaches in force in EU MS. The analysis covers six sample MS covered by fieldwork - i.e. Austria, Belgium, Germany, Italy, Poland and Romania - which account for almost 90% of the total consumption of sweetened/flavoured beer in the 14 MS that have opted for fixing excise duty with reference to the Plato degree.<sup>341</sup>

### 2.6.1 Baseline assessment

'Sweetened/flavoured beer' refers to a range of products essentially consisting of a mixture of standard beer with non-alcoholic additives and/or drinks. In a nutshell, there are two main types of sweetened/flavoured beer:

- First, beer mixed with lemonade (or other non-alcoholic beverages and juices like ginger ale, apple, grapefruit, or orange juice) typically in a 50:50 ratio, which is called 'radler' or 'shandy' - hereinafter '**radler**'.<sup>342</sup> The lemonade is added to the 'base beer', after fermentation. A standard radler contains only 2-2.5% vol of alcohol, and even less in some cases.<sup>343</sup>
- Second, beer to which a small amount of fruit, juice, sugar and/or fruit or non-fruit concentrated flavours<sup>344</sup> are added - hereinafter '**other sweetened/flavoured beer**'. The additive usually makes up only a small part of the weight and volume of the final beer; it can be added to the wort, before fermentation (e.g. 'kriek'<sup>345</sup>), or to the 'base beer', after fermentation.<sup>346</sup>

#### 2.6.1.1 The EU market for sweetened/flavoured beer

The EU market for sweetened/flavoured beer is relatively small, but growing. This has been confirmed by all relevant stakeholders interviewed during the fieldwork phase. Compared to the overall EU beer market, the market share of these products is about

<sup>340</sup> This code includes beer made from malt.

<sup>341</sup> The following EU MS apply has opted for the Plato degree approach: AT, BE, BG, CZ, DE, EL, ES, IT, LU, MT, NL, PL, PT, and RO.

<sup>342</sup> Radler, the German notion for *shandy*, has become the dominant term. Other words for radler are *panaché* (French) and *clara* (Spanish). Sometimes the term radler only refers to beer with citrusy additions, whereas *shandy* encompasses also other tastes. In this study, though, radler denotes any roughly 50:50 mixture of beer and a non-alcoholic beverage like lemonade, juice, ginger ale etc.

<sup>343</sup> Based on the review of a sample of 14 radler products in six MS: Austria, Belgium, Germany, Italy, Poland, and Romania.

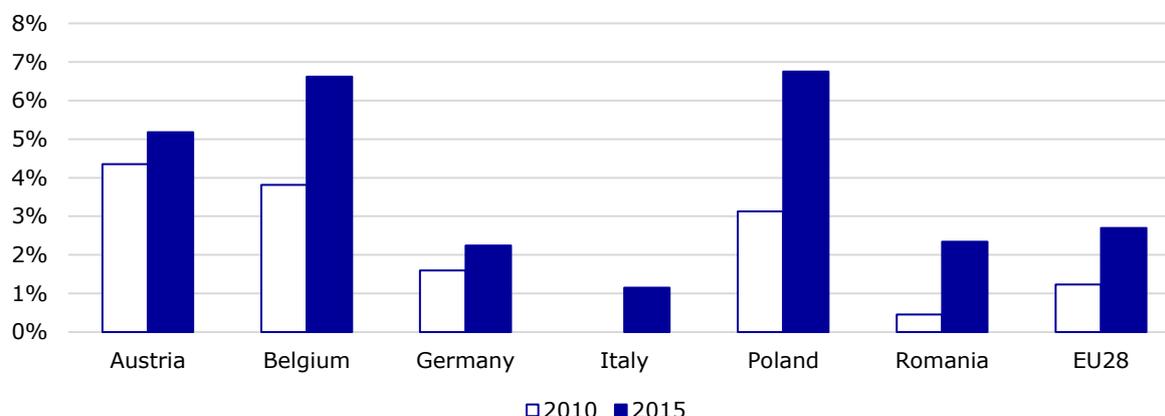
<sup>344</sup> Certain tequila-flavoured beer is classified as beer under CN code 2203, according to Regulation 1967/2005.

<sup>345</sup> Some types of kriek may also include sugar added after fermentation.

<sup>346</sup> This distinction has been confirmed by economic operators interviewed for this Assignment.

2.7% (2015), up from 1.2% in 2010 (see Figure 13).<sup>347</sup> Almost half of the EU consumption seemingly concentrates in Germany and Poland, which account for three-quarter of the overall consumption in MS applying the Plato method (Figure 14).

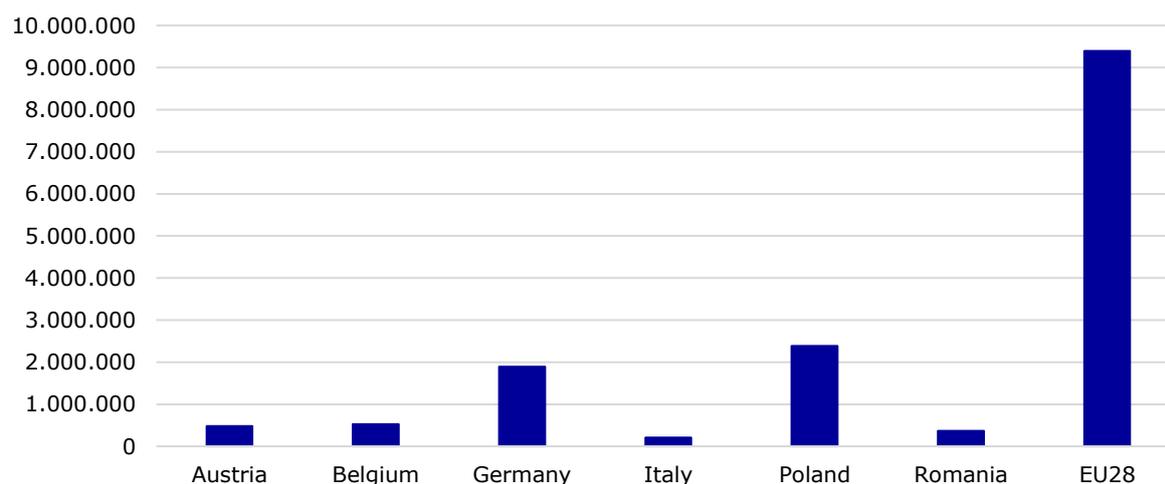
**Figure 13 – Market share for sweetened/flavoured beer out of the total market for beer, in selected MS**



**Source:** Author's elaboration, based on IWSR database.

**Note:** Belgium includes also Luxembourg.

**Figure 14 – Total consumption of sweetened/flavoured beer (2015, hectolitre)**



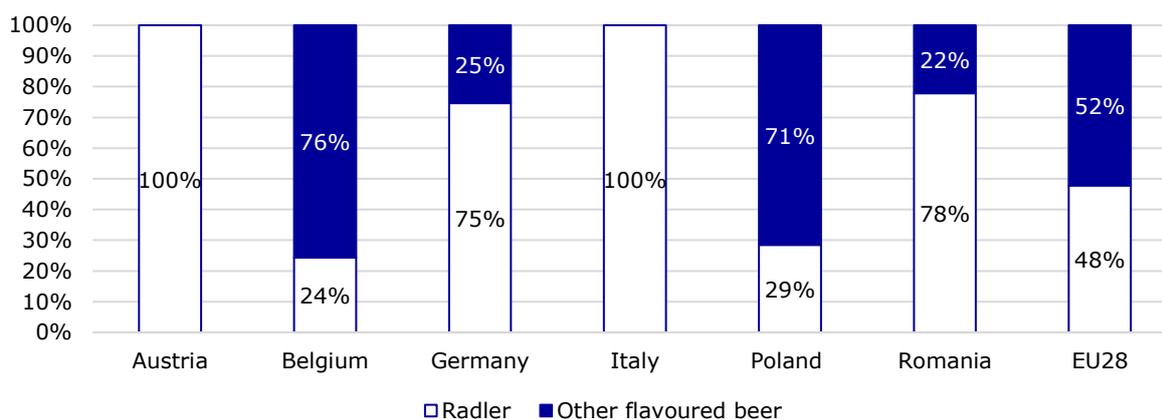
**Source:** Author's elaboration, based on IWSR database.

**Note:** Belgium includes also Luxembourg.

Radler makes up a large portion of sweetened/flavoured beer in Europe, but its relative share has recently decreased from 63% in 2010 to 48% in 2015 (see Figure 15), due to the more prominent growth of other sweetened/flavoured beer. The market structure varies significantly across MS: radler seemingly account for 100% of all sweetened/flavoured beers in Austria and Italy,<sup>348</sup> 75% in Germany, and only 24% in Belgium (2015). In some countries like Belgium and Romania, consumption of radler increased considerably over the past years in absolute terms.

<sup>347</sup> Similar shares are registered in MS applying the Plato method.

<sup>348</sup> Whereas this information has been confirmed by Austrian stakeholders, in Italy there is a small, but declining market for flavoured beer, which appears not to be recorded by IWSR data. Nonetheless, the Italian market for flavoured beer other than radler is dominated by beer with addition of flavour in the wort produced by craft brewers; the Plato degree of such beer is not affected by different measurement approaches (see below). Hence, IWSR data allows capturing the entire market relevant to the policy problem discussed in this Section of the Study (see below).

**Figure 15 – Market share of radler and other flavoured beer (2015)**

**Source:** Author's elaboration, based on IWSR database.

**Note:** Belgium includes also Luxembourg.

The IWSR database reports a market growth by 6% between 2015 and 2016 for sweetened/flavoured beer, and projects a market growth by 8.5% in 2017, to reach total consumption of almost 11 million hectolitres. A *Technavio* study<sup>349</sup> forecasts steady growth for sweetened/flavoured beer in Europe through 2020, while the demand for standard beer is assumed to keep decreasing, due inter alia to increased competition from other alcoholic beverages like cider and wine.<sup>350</sup> In this context, sweetened/flavoured beer is part of a strategy of brewers to innovate and regain market shares. This trend involves both mainstream beer brands – many of which have introduced sweetened/flavoured beer, and especially radler, in recent years – as well as the craft beer industry. In fact, as confirmed by various interviewees, craft brewers usually produce speciality beer, which is more often flavoured compared to standard beer made by large-scale producers.<sup>351</sup>

Based on IWSR data, the average price of sweetened/flavoured beer is higher than that of standard beer (i.e. 247 €/hl against 215 €/hl). More specifically, radler seems on average cheaper (170 €/hl) while other sweetened/flavoured beer seems much more expensive (318 €/hl) than standard beer. Indeed, other sweetened/flavoured beer are generally marketed as premium product.<sup>352</sup> A recent *Technavio* study predicts that 70% of sweetened/flavoured lager will be in the premium lager category in the period 2016-2020. These considerations have been confirmed by most of beer producers interviewed for this Study, who explained that production costs for other sweetened/flavoured beer tend to be higher than production costs for standard beer.

### 2.6.1.2 Application of the Plato method to sweetened/flavoured beer

<sup>349</sup> For further details see DBR, 'Study says increasing demand for craft beer will boost Europe's beer market through 2020', 2017 <http://beer.drinks-business-review.com/news/demand-for-low-or-non-alcoholic-beer-to-grow-in-europe-through-2020-030117-5708450> (last accessed on 10 July 2017).

<sup>350</sup> For further details, see Datamonitor, 'New Developments in Radlers, Shandies, and Pre-Mixed Beer Drinks', 2013, executive summary available at <https://www.slideshare.net/cteahan/new-developments-in-radlers-shandies-and-premixed-beer-drinks> (last accessed on 10 July 2017) (2013) and *DBR (2017)*

<sup>351</sup> See, for instance, 'US beer market is bursting with flavour: 80% increase in flavoured beer launches 2010-15' at <http://www.mintel.com/press-centre/food-and-drink/us-beer-market-is-bursting-with-flavor-80-increase-in-flavored-beer-launches-2010-15> (last accessed on 10 July 2017); and 'Celebrating the small, independent and traditional craft brewers' <https://www.brewersassociation.org/communicating-craft/celebrating-small-independent-traditional-craft-brewers/> (last accessed on 10 July 2017).

<sup>352</sup> For further details see Datamonitor (2013).

As seen, Article 3(1) of the Directive allows MS to levy excise duty on beer by reference either to the number of hectolitre/degrees Plato, or the number of hectolitre/degrees of actual ABV. A succinct review of the two measurement methods is provided in Box 20.

**Box 20 – Overview of ABV v. Plato degree measurement methods**

Table 46 provides a summary of the main differences between the ABV and Plato methods.

**Table 46 – Key differences between ABV and degree Plato**

<b>ABV</b>	<b>Degree Plato</b>
Global standard	Only used in 14 EU countries
Used as indicator for consumers and often also for taxation	Used for taxation in some countries Used in production process to estimate fermentability of the wort
Measures percentage of ethanol by volume	Measures percentage of extract by weight
Measured with hydrometer	Measured with refractometer or hydrometer
No linear conversion is possible, but approximately 0.4 ABV = 1° Plato	

**Source:** Author’s elaboration of interviews with stakeholders and desk research.

ABV is the standard measure of alcohol content in fluids. It is used globally by producers and serves as a universal indicator for consumers. As for beer, ABV is estimated by measuring the density of the beer. At 20°C, it measures the number of millilitres of pure ethanol present in 100ml of a solution. In fermentation, yeast produces alcohol from sugar. Sugar density in water is larger than alcohol density. Hence, by comparing the beer density before and after fermentation, the volume of alcohol can be estimated. Density is usually derived from specific gravity, which is measured with a hydrometer. The specific gravity is the ratio of the density of the liquid to the density of water. Consequently, the following formula measures alcohol by volume:

$ABV = 131.25(OG - FG),^{353}$  where OG denotes the original gravity (before fermentation) and FG the final gravity (after fermentation) of the beer.

The Plato method differs from ABV in that it seeks to estimate the concentration of extract in a fluid as a percentage by weight. For example, in a 12° Plato beer the extract makes up 12g per 100g of wort. The extract contains mainly sugar derived from malt, but can also include other soluble material in the wort. For a brewer, the Plato approach exhibits the advantage of measuring the beer in terms of the amount of fermentable materials (sugars) in the wort. The Plato method focuses on the real weight of the extract, rather than a relative density compared to the density of water (like ABV). Plato is a method traditionally applied in central Europe. It is used in 14 EU countries to report alcohol content for taxation purposes (see below).

Reportedly, it is not possible to create an exact conversion table between Plato degree and ABV. Therefore, measuring Plato and ABV strength require different tests. The approximate conversion is not linear, but roughly 1 Plato degree equals 0.4% vol.<sup>354</sup>

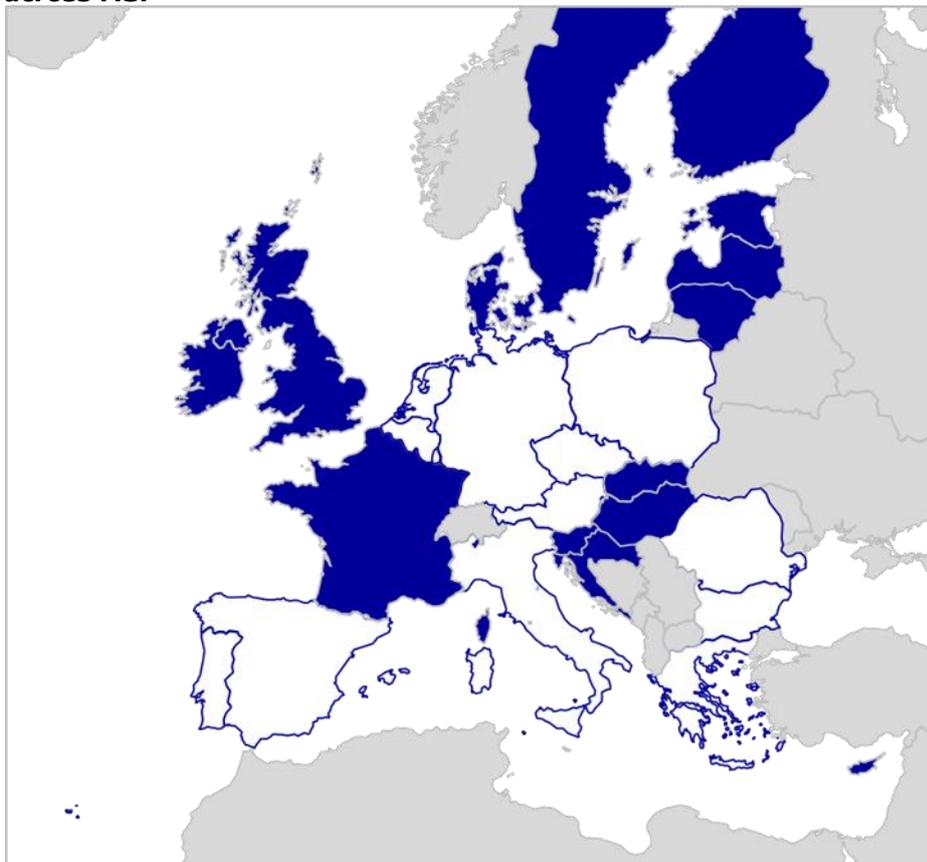
Figure 16 shows that half of the MS apply excise duty on beer by relying on the Plato method (white) and the other half base their excise duty on ABV measurement (dark blue).<sup>355</sup>

<sup>353</sup> Sometimes 133 is used instead of 131.25 as the constant, depending on the °C at which ABV is measured.

<sup>354</sup> See European Commission, ‘EU rules for the taxation of alcohol’, 2016; and London Economics (2010).

<sup>355</sup> For further details, see the Ramboll Evaluation (2016).

**Figure 16 – Application of the Plato or ABV method to establish the excise duty on beer across MS.**



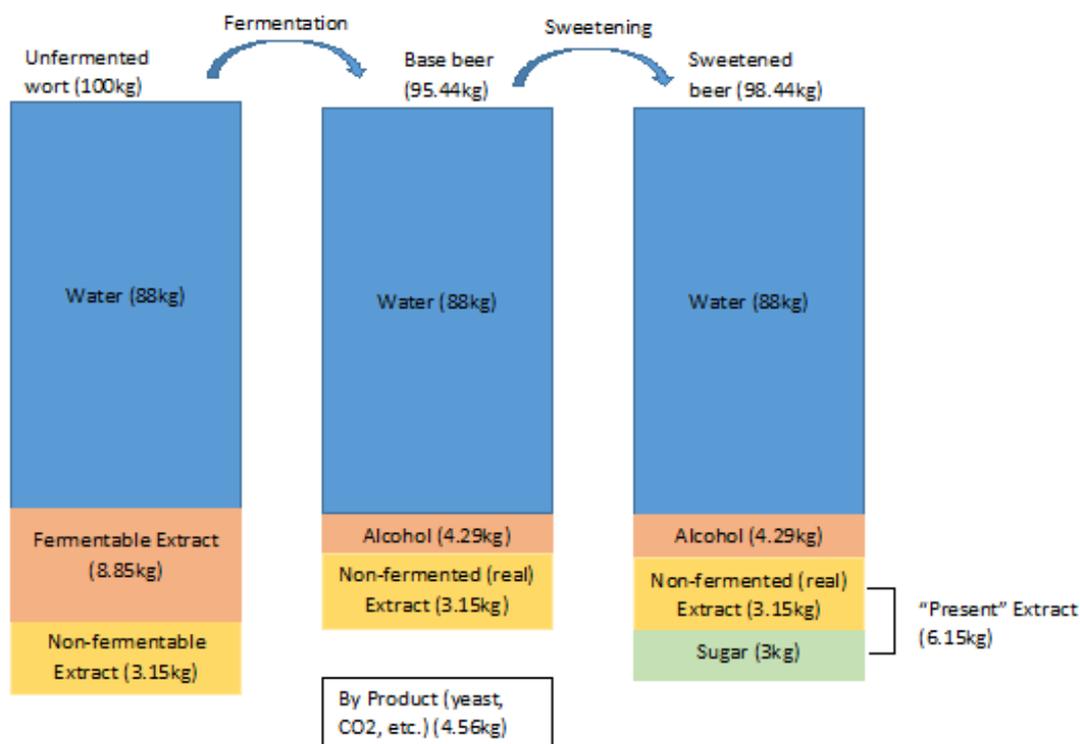
**Source:** Ramboll Evaluation (2016).

### 2.6.1.3 Production process for sweetened/flavoured beer

To understand the options of measuring the Plato degree of sweetened/flavoured beer, it is useful to consider the production process, which consists of three main steps (see Figure 17):

- (i) First, the wort is created from the blending of crushed malted barley and hot water. For instance, as shown in Figure 17, 100kg of unfermented wort contain 88kg of water, 8.85kg of 'fermentable extract', and 3.15kg of 'non-fermentable (or real) extract'.
- (ii) Second, fermentation converts part of the 'fermentable extract' into alcohol. The wort turns into the 'base beer'. However, not all 'fermentable extract' is transformed into alcohol. In 1843, the Bohemian scientist Karl Balling found that 2.066g of 'fermentable extract' created 1.000g of alcohol and 1.066g of by-products (e.g. brewers' yeast and CO<sub>2</sub>). This ratio is fixed and is hence used to calculate the Plato degree of beer. The by-product is usually removed from the base beer, which in the example below after fermentation only weighs 95.44kg.
- (iii) Finally, to obtain sweetened/flavoured beer, additional unfermented sugar/flavour is added to the 'base beer' (e.g. 3kg in the example below, which reflects the brewing process for sweetened/flavoured beer other than radler). Consequently, the sweetened/flavoured beer is heavier than the base beer (98.44kg in Figure 17). 'Present extract' is calculated as the sum of the 'real extract' and the added sugar/flavour in the sweetened/flavoured beer (6.15kg in the example).

**Figure 17 – The production process for sweetened/flavoured beer and determination of extract**



**Source:** *Brewers of Europe*.<sup>356</sup>

**Note:** This example describes the production process of sweetened/flavoured beer other to which sugar/flavour is added after fermentation.

Before discussing the different approaches to measure the strength of sweetened/flavoured beer via the Plato method, two caveats are required:

- The brewing process in Figure 17 is relevant only for sweetened/flavoured beer to which sugar/flavour is added after fermentation. Flavoured beer with additives included in the wort usually do not undergo the subsequent sweetening process. Additives included in the wort are either transformed into alcohol or part of non-fermented (real) extract.
- The example in Figure 17 corresponds to the production of sweetened/flavoured beer other than radler as a relatively small amount of sugar/flavour is added. For a typical radler, the base beer is mixed with a larger quantity of lemonade (typically 50:50 proportion), so both water and sugar are added to prepare the final product. For instance, 100 kg of lemonade (90 kg of water plus 10kg sugar and lemon flavour) may be added to the base beer instead of the 3kg of sugar in the example above. In this case, the final beer would weigh 195.44kg and the present extract would weigh 13.15kg.

#### 2.6.1.4 Approaches to measuring the Plato degree of sweetened/flavoured beer

Article 3(1) of the Directive requires MS to calculate the Plato degree of 'finished products', yet the Directive does neither clarify what is a 'finished product' in the case of a sweetened/flavoured beer nor provide guidance on the correct method to measure its Plato degree. So, three different interpretations and measurement methods exist to

<sup>356</sup> *Brewers of Europe* (18 May 2016), 'European approach to calculation of Plato', presentation.

determine the Plato degree of sweetened/flavoured beer.<sup>357</sup> The first takes into account only the ingredients of the base beer, whereas the second and third approach consider also the ingredients added later in the process. A technical review is provided in the following sub-sections.

➤ **APPROACH A: MEASURING THE PLATO DEGREE BEFORE ADDING SUGAR/FLAVOURS**

This approach aims to calculate the Plato degree of the base beer, prior to the addition of sugar/flavours. This is similar to calculating the Plato degree of non-sweetened or non-flavoured beer. In this case, one calculates the Plato degree based on the Balling formula using the real extract and mass of the base beer (Figure 17). The alcohol strength of the base beer in Plato degree is measured as follows:

$$Plato\ degree = \frac{(2.066 \times Alcohol) + Real\ extract}{Mass\ of\ beer + (1.066 \times Alcohol)} * 100$$

Therefore, following the example provided in Figure 17, the base beer is brewed at 12° Plato:

$$\frac{(2.066 * 4.29kg) + 3.15kg}{95.44kg + (1.066 * 4.29kg)} * 100 = 12^\circ\ Plato$$

This approach, which is reportedly applied by Romanian authorities, focuses entirely on the features of the base beer. In fact, the quantity of water/sugar added to obtain the sweetened/flavoured beer has no impact on the Plato degree of the base beer. For tax purposes, approach A requires to apply the excise duty only to the quantity of base beer contained in the sweetened/flavoured beer. For instance, a consumer of radler including 50% of beer at 12° Plato and 50% of lemonade, would pay excise duty only on 50% of the content of the purchased bottle/can.

There is no difference between approach A and the two other approaches (B1, B2) described below with regard to sweetened/flavoured beer to which additives are included already in the wort; in such a case, the base beer corresponds to the bottled product and the real extract corresponds to the present extract.

➤ **APPROACH B1: MEASURING THE PLATO DEGREE AFTER ADDING SUGAR/FLAVOURS, ON THE REAL EXTRACT**

This approach aims to calculate the Plato degree of the sweetened/flavoured product after the addition of sugar/flavours, by taking into account the 'non-fermented (real) extract', i.e. the extract of the base beer without considering sugar/flavours added to the sweetened/flavoured beer after fermentation, and the total mass of the sweetened/flavoured beer. The approach best reflects the actual alcohol content of the product, and is calculated as follows:

$$Plato\ degree = \frac{(2.066 \times Alcohol) + Real\ extract}{Mass\ of\ beer + (1.066 \times Alcohol)} * 100$$

In our example, this approach yields 11.7° Plato for the sweetened/flavoured beer.

$$\frac{(2.066 * 4.29kg) + 3.15kg}{98.44kg + (1.066 * 4.29kg)} * 100 = 11.7^\circ\ Plato$$

<sup>357</sup> Approaches to measure the Plato degree of sweetened/flavoured beer that are assessed in this Study have been selected because they either are currently applied by EU MS or will be potentially adopted in coming years.

According to some stakeholders this approach might be introduced by Italian authorities, which currently use the approach B2, below.<sup>358</sup>

➤ **APPROACH B2: MEASURING THE PLATO DEGREE AFTER ADDING SUGAR/FLAVOURS, ON THE PRESENT EXTRACT**

This approach aims to calculate the Plato degree of the sweetened/flavoured product after the addition of sugar/flavours, by taking into account the 'present extract', i.e. the extract of the sweetened/flavoured beer also considering the sugar/flavours included in the sweetened/flavoured product, and the total mass of the sweetened/flavoured beer. It is calculated by applying this formula:

$$\frac{(2.066 \times \text{Alcohol}) + \text{Present extract}}{\text{Mass of beer} + (1.066 \times \text{Alcohol})} * 100 = \text{Plato}$$

In our example, this approach leads to 14.57° Plato:

$$\frac{(2.066 \times 4.29\text{kg}) + 6.15\text{kg}}{98.44\text{kg} + (1.066 \times 4.29\text{kg})} * 100 = \mathbf{14.57 \text{ degrees Plato}}$$

Reportedly, this is the most used approach by tax authorities in Plato countries. Among surveyed countries, it is applied in Austria, Belgium, Germany and Poland (Table 47). Nonetheless, it is acknowledged that this approach may overestimate the Plato degree of the sweetened/flavoured beer (see below); for this reason, the beer industry claims this method is technically incorrect. Reportedly, there is virtually no difference between method B1 and method B2 in case of artificial sweeteners (e.g. aspartame), as such sweeteners can be identified by customs lab and excluded from the calculation of the present extract.<sup>359</sup>

**Table 47 – Approaches adopted by sample MS to measuring the Plato degree of sweetened/flavoured beer**

Approach A	Approach B1	Approach B2
Romania	Italy(?) (possible transition from current approach B2)*	Austria, Belgium, Germany, Poland.

**Source:** Author's elaboration of interviews with stakeholders.

### 2.6.1.5 Tax revenues from sweetened/flavoured beer

To estimate tax revenues from consumption of sweetened/flavoured beer, it is necessary to rely on some assumptions regarding their average Plato degree (Table 48). In this respect, a distinction between radler and other sweetened/flavoured beer has to be made. Based on interviews with stakeholders and expert assessment, it is reasonable to assume that a 'typical' radler contains 50% of low gravity base beer (at about 11° Plato) and 50% of lemonade. By applying the formulas above, this would lead to a Plato degree between 5.5° (approach A) to 10° (approach B2). By contrast, a 'typical' sweetened/flavoured beer with concentrate additive added after fermentation would

<sup>358</sup> See Article 35 of 'Decreto Legislativo 504/1995' as recently amended by Decreto Legge 193/2016 converted into law with amendments by Legge 225/2016. The provision requires secondary rules for its implementation (e.g. establishing the point of measurement, approved equipment etc.) However, it is unlikely that these rules will be adopted prior to the CJEU pending ruling on case C-30/17.

<sup>359</sup> Tax authorities interviewed for this Study argued that few brewers actually use sweeteners instead of sugar, which shows the extra excise duty is not a high burden for them. By contrast, brewers explained that the choice to use sugar rather than artificial sweetener is driven by marketing considerations, e.g. using only natural ingredients, rather than by cost considerations, e.g. tax savings.

reflect the example in Figure 17 above and have a Plato degree ranging from 11.7° to 14.6°.

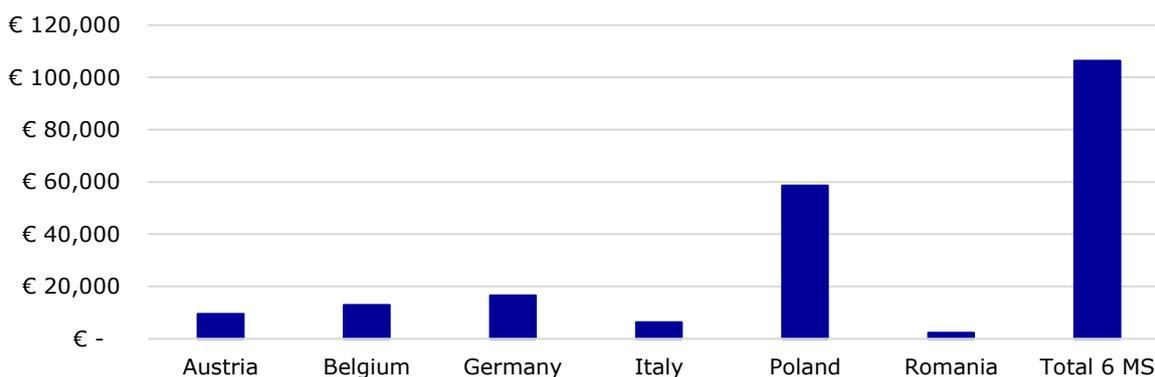
**Table 48 – Composition and typical strength of sweetened/flavoured beer**

	Radler (50% lemonade)	Other sweetened/flavoured beer (Additive added after fermentation)
Alcohol	4.495 kg	4.495 kg
Real extract	2.200 kg	3.301 kg
Mass of the base beer	100 kg	100 kg
Sugar added	9 kg	3.143 kg
Water added	91 kg	0 kg
Mass of the sweetened beer	200 kg	103.143 kg
Plato degree (approach A)	5.5° (base beer at 11.0°)	12.0°
Plato degree (approach B1)	5.6°	11.7°
Plato degree (approach B2)	10.0°	14.6°

**Source:** Author's elaboration of interviews with stakeholders and expert assessment.

By relying on the average Plato degree in Table 48, the market data presented above, and based on the approaches adopted by MS authorities, the tax revenues from excise duty on sweetened/flavoured beer would range from EUR 2.3 million in Romania to EUR 58.6 million in Poland, leading to a total of about EUR 106 million in the six surveyed countries (2015 data). To put these numbers in context, this is equal to ca. 1% of the total excise duty revenues from beer in Italy and Romania, and to almost 7% in Belgium and Poland (Figure 19).

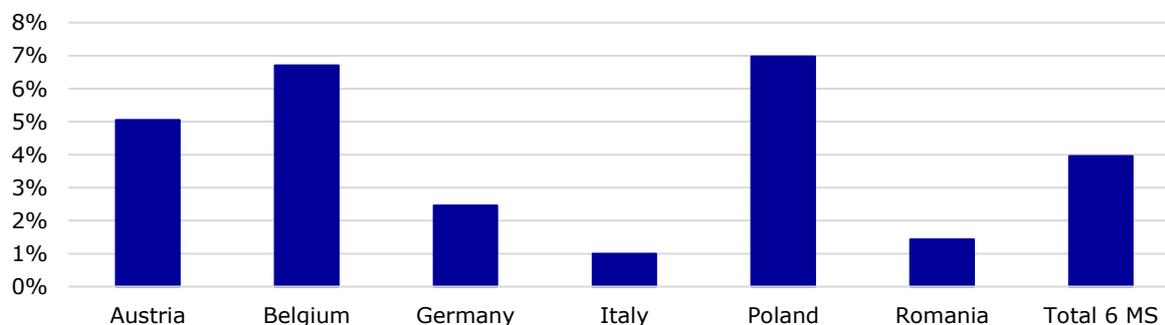
**Figure 18 – Excise duty revenues from sweetened/flavoured beer (2015, € '000)**



**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Estimate on typical radler and other sweetened/flavoured beer (see Table 48). Approach A adopted in Romania. Approach B2 applied in Austria, Belgium, Germany, Italy and Poland.

**Figure 19 – Excise duty revenues from sweetened/flavoured beer out of total tax revenues on beer (2015)**



**Source:** Author's elaboration of IWSR and EDT series (2015 and 2016 for tax receipts).

**Note:** Estimate on typical radler and other sweetened/flavoured beer (see Table 48). Approach A adopted in Romania. Approach B2 applied in Austria, Belgium, Germany, Italy and Poland.

The estimates above are based on the assumption that all sweetened/flavoured beer consumed in the six sampled MS is prepared by including some sugar/flavour added after fermentation. In fact, data available (IWSR) does not allow identifying beer to which flavour is only added in the wort. As each of the approaches presented above (A, B1 and B2) results in the same Plato degree for beer flavoured in the wort, this assumption leads to an upper bound estimate of the market affected by the policy problem discussed below.

## 2.6.2 Problem analysis

Since there are no harmonised rules on how to measure the Plato degree of sweetened/flavoured beer, MS may either define the 'finished product' as the quantity of base beer in the mixture and apply approach A; or they may define the 'finished product' as the entire quantity of sweetened/flavoured beer and opt for either approach B1 or B2 above.<sup>360</sup> As discussed, whereas the different approaches have no impact on measuring the Plato degree of sweetened/flavoured beer with additives included in the wort, they have a significant impact on measuring the Plato degree of radler and other sweetened/flavoured beer with additives added after fermentation. Against this background, the adoption by MS of approach A, B1, or B2 affects the level of excise duty applied, the price paid by consumers and the tax revenues generated by such products. Depending on which approach is chosen, the result can be that a different excise duty is applied to products with the same alcoholic content (Table 49). Based on that, some beer producers claims that an incorrect method of measuring the Plato degree may ultimately lead to distortions of competition.<sup>361</sup>

**Table 49 – Estimated excise duty for sweetened/flavoured beer under the different approaches (per hl of product)**

		Excise duty on beer (EUR/hl/° Plato)	Approach A Excise duty per hl (EUR)	Approach B1 Excise duty per hl (EUR)	Approach B2 Excise duty per hl (EUR)
<b>Austria</b>	Radler	2.00	10.96	11.22	20.01
	Other sweetened/flavoured beer		24.02	23.32	29.15
<b>Belgium</b>	Radler	1.85	10.12	10.36	18.48
	Other sweetened/flavoured beer		22.19	21.54	26.92
<b>Germany</b>	Radler	0.79	4.31	4.41	7.87
	Other sweetened/flavoured beer		9.45	9.18	11.47
<b>Italy</b>	Radler	3.04	16.66	17.05	30.41
	Other sweetened/flavoured beer		36.52	35.45	44.30
<b>Poland</b>	Radler	1.86	10.19	10.43	18.61
	Other sweetened/flavoured beer		22.34	21.69	27.11
<b>Romania</b>	Radler	0.88	4.84	4.96	8.84
	Other sweetened/flavoured beer		10.62	10.31	12.88

*Source:* Author's elaboration of EDT series (2015).

*Note:* Estimate on typical radler and other sweetened/flavoured beer (see Table 48).

The issue has already caused a few disputes between brewers and tax authorities, and generated judicial costs and other unduly burdens. For instance, in Germany, a brewer went to court in 1997 seeking to have its radler taxed based on method B1 rather than

<sup>360</sup> It is worth remarking that approaches to measure the Plato degree of sweetened/flavoured beer that are assessed in this Study have been selected because they either are currently applied by some EU MS (A and B2) or will be potentially adopted in coming years (B1).

<sup>361</sup> See also Ramboll Evaluation (2016).

B2.<sup>362</sup> The national court finally decided against the brewer's plead in 2004, and since then there have not been further complaints against the use of method B2 in Germany. More recently a similar case has been brought to court by a Polish brewer (see Box 21); this case has been referred to the CJEU (C-30/17 - *Kompania Piwowarska*).

**Box 21 - The Court of Justice case C-30/17: *Kompania Piwowarska* (Poland)**

As mentioned, the Directive does not provide a definition of 'finished product' to measure beer strength. This may lead to litigation between beer producers and tax authorities, especially when it comes to the application of the Plato method to sweetened/flavoured beer. A case in point is the recent lawsuit that has been referred by the Director of the Customs Chamber in Poznan to the CJEU. The case opposes a Polish beer company producing sweetened/flavoured beer and the Polish tax authority. The different views of the brewer and the Polish tax authority can be summarised as follows.

The brewer argues that the strength of the sweetened/flavoured beer in Plato degree should be measured accounting for the 'real extract' (method B1) rather than 'present extract' (method B2) of the final product. Including the sugar added after fermentation in the extract figure would be a technically wrong measurement, because this sugar does not add to alcohol formation. By contrast, the Polish tax authority requires method B2, i.e. measuring the Plato degree on the basis of the present extract, including the sugar added after fermentation.

The Polish case clearly demonstrates the importance of the problem for both beer producers and tax authorities. By adopting the brewer's approach, the beer producer (tax authorities) must pay (receive) PLN 87.8, whereas by adopting the tax authority's approach it must pay (receive) PLN 109.8 (figures correspond to the example in Figure 17) per hectolitre of beer. Different interpretation of the way of applying the Plato method to sweetened/flavoured beer can lead to differences in excise duty for the same product. This case is further complicated by the fact that the brewer is asking to retroactively apply method B1 in order to recover excise duty paid in excess in past years.

The CJEU is called to rule on whether the Plato degree of sweetened/flavoured beer should be measured by considering either the 'real extract' or the 'present extract'. It is worth noting that the Court is not asked to decide whether the calculation of the Plato degree should be done before adding sugar (i.e. on the 'base beer') or after adding sugar (i.e. on sweetened beer). In this respect, both the brewer and the tax authority agree that sweetened beer is the 'finished product' for excise duty purposes.

Approaches A and B1 generate some problems when it comes to enforcement, since national authorities are reportedly not able to measure the Plato degree of the base beer by analysing the content of the bottled product. The customs laboratories interviewed for this Study have explained that, currently, there is no method to distinguish the base beer and lemonade or other additives after mixing. Therefore, any check should be done on the production site by measuring both the Plato degree of the base beer and the quantity of base beer included in the end-product. In the same vein, with few exceptions (e.g. when the beer is sweetened/flavoured by artificial sweeteners, which are unambiguously different from sugar in real extract), it is not possible to distinguish between the real extract and the present extract by analysing the bottled product. Again, checks need to be performed on the production site by measuring the real extract used to produce the base beer. In this context, enforcement problems become more prominent when it comes to applying excise duty on sweetened/flavoured beer moved from another MS, as tax authorities could hardly perform checks in plants based in a different country.

Finally, any change in excise duty would be likely reflected in a change in price and, in turn, in consumption of sweetened/flavoured beer. Distortions in prices and consumption may also engender, to a minor extent, public health policy issues.<sup>363</sup> For instance, sweetened/flavoured beer is thought to be more attractive for women and young consumers and both are not established beer drinking groups, which is confirmed by the

<sup>362</sup> For further details, see [https://www.jurion.de/urteile/bfh/2006-03-28/vii-r-39\\_04/](https://www.jurion.de/urteile/bfh/2006-03-28/vii-r-39_04/) last accessed 31.07.2017.

<sup>363</sup> See also IIA (2017).

fact that 40% of radler drinkers are new to the beer category.<sup>364</sup> However, research has shown that marketing plays a greater role in attracting these consumer groups than the actual content/taste of a beer.<sup>365</sup> On the other hand, radler contains less alcohol (2-2.5% vol) than standard beer, so it may eventually reduce the overall alcohol intake and - as discussed in Section 2.4 - have positive public health impacts.

➤ **SUMMARY OF PROBLEM ANALYSIS**

Problem drivers	Adverse Effects	Expected evolution
<p><b>Unclear definition of finished product and lack of guidance on the most correct approach to measure the Plato degree when it comes to sweetened/flavoured beer</b></p>	<ul style="list-style-type: none"> <li>• Beer products with the same alcohol content may be taxed differently, thus leading to unfair competition</li> <li>• Beer producers and tax authorities disagree on measurement of the Plato degree, thus leading to legal proceedings</li> <li>• Approaches A and B1 do not allow customs lab to perform checks on bottled product, thus generating enforcement problems and costs</li> <li>• Tax on sweetened/flavoured beer is computed differently in different MS, possibly affecting competitiveness and demand.</li> </ul>	<ul style="list-style-type: none"> <li>• The CJEU is called to decide whether the Plato degree of sweetened/flavoured beer should be measured by adopting approach B1 or B2</li> </ul>

<sup>364</sup> For further details, see Datamonitor (2013).

<sup>365</sup> For further details, see WHO, 'Global status report: alcohol and young people', 2001; and: 'Beer and Health: Moderate consumption as part of a healthy lifestyle', at <http://beerandhealth.eu/wp-content/uploads/2016/07/beer-and-health-web.pdf> (last accessed on 10 July 2017). Stakeholders have also confirmed this statement.

### 3 DEFINITION AND IMPACT ANALYSIS OF POLICY OPTIONS

#### 3.1 Classification of alcoholic beverages

##### 3.1.1 Overview

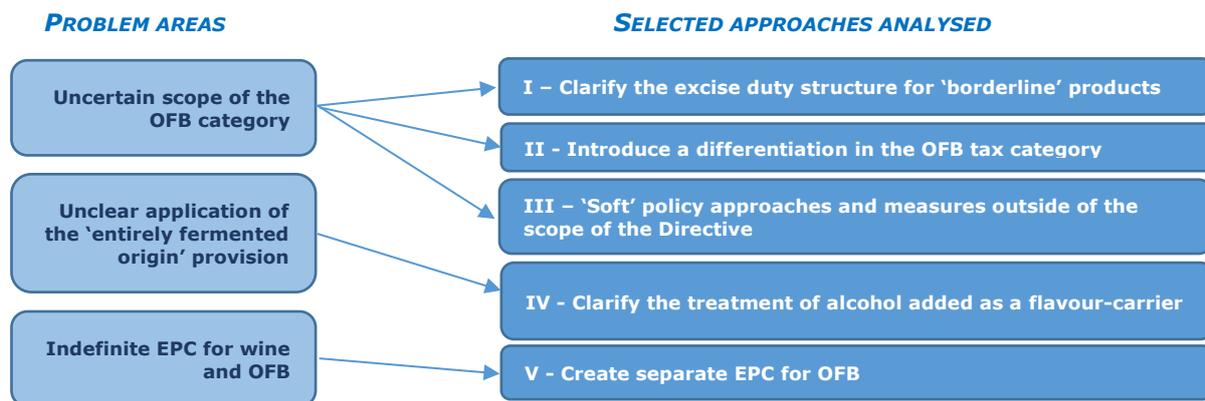
➤ **THE STRUCTURE OF THE ANALYSIS OF POLICY OPTIONS**

The purpose of this Section is to develop a set of policy options to address the three problem areas extensively analysed in the previous Section 2.1 ('classification issues') and estimate the nature and the magnitude of their impact if they were adopted. The policy options retained for the analysis were preliminarily identified during the Inception Phase, in the light of the recommendations of the Ramboll Evaluation and the following DG TAXUD's Report and Inception Impact Assessment. Based on the evidence collected from the fieldwork and the results of the baseline assessment, they have been refined and further developed. We have discarded at an early stage the options that appeared clearly unfeasible or ineffective or manifestly inferior to similar solutions, and we focus in this Section on more realistic ones.

For each of the problems identified we provide (i) a definition of the policy options considered (and an explanation for those not considered); (ii) the identification of the relevant impact areas, including both intended and unintended effects; and (iii) a measurement of the magnitude of the impact expected, based on a triangulation of quantitative methods – when feasible and relevant – and qualitative evidence (interviews and OPC results).

Certain problems may have more than one possible solution, either alternative or complementary. When certain solutions appear as variants of the same approach they have been discussed jointly, otherwise they have been presented separately. This is the case with the broad issue concerning the scope of the OFB category for which three main approaches have been identified (Figure 20). The analysis of impact is instead organised by impact area and covers jointly the different solutions and variants proposed so as to highlight the differences in the expected results.

**Figure 20 – Correspondence between classification problem areas and selected policy options**



➤ **THE OVERALL STAKEHOLDERS' FEEDBACK ON A POSSIBLE REVISION OF THE DIRECTIVE**

Before delving into a systematic assessment of the options for change it is useful to highlight that the evidence collected from stakeholders' consultation suggests there is a quite low appetite for major changes of the Directive. According to OPC results, there is

limited need to reconsider the classification of certain 'borderline' products in order to achieve a more equitable tax treatment. As shown in Figure 21, only the beer industry would be in favour of reviewing the way certain fermented beverages are treated (RTDs and medium/high strength beverages with a fermented base).

The feedbacks collected through in-depth interviews concur on the fact that the origin of classification problems lies outside of Directive 92/83/EEC, and should be rather sought in the CN classification rules and/or in the disparities in national sectoral legislation. In particular, economic operators generally admit that the current rules are complex but do not hamper the functioning of the Single market, whereas a revision of the Directive would only modestly address existing problems but might translate into new problems and distortions. National administrations have more mixed views than the industry, and some concede there would be added value in establishing clearer and common criteria for distinguishing between CN 2206 and CN 2208, as well as in a few other 'surgical' interventions on the text of the Directive (e.g. on the notion 'entirely fermented origin'). The limited economic importance of 'borderline' products (as compared to beer, wine and spirits) may play a role in it, and some public authorities questioned the proportionality of a regulatory change motivated by such a small issue.

For completeness, it is worth summarising the main points of a recently issued REFIT Platform Opinion that addressed some of the present issues.<sup>366</sup> In particular, it emerged that while various Member States support more accurate definitions and greater clarity in legislation in order to reduce legal uncertainty, views are divided on whether this should be achieved by establishing common thresholds on the amount of fermented alcohol used in mixtures. More generally, the debate showed also the persistence of divided views on the structure of excise duty, with some MS that would be in favour of taxation per alcohol content, while for other MS the current rules should not be touched, since are the result of a compromise aiming at safeguarding the specific interests of the Member States while permitting a minimum harmonisation of excise duties. As discussed in the Introduction, the revision of excise duty structures adopting a 'per alcohol content' approach – which is supported inter alia by various public health stakeholders and some segments of the industry – is outside of the scope of this regulatory revision process, hence is not covered in this IA Study. It is nonetheless worth mentioning that at ITEG level, there seems to be interest by certain MS to promote a mixed approach on this issue, and revise the Directive in a way that each MS may decide whether to tax wine, OFB and IP per volume of finished product (as it is today) or per degree of actual alcoholic strength.<sup>367</sup>

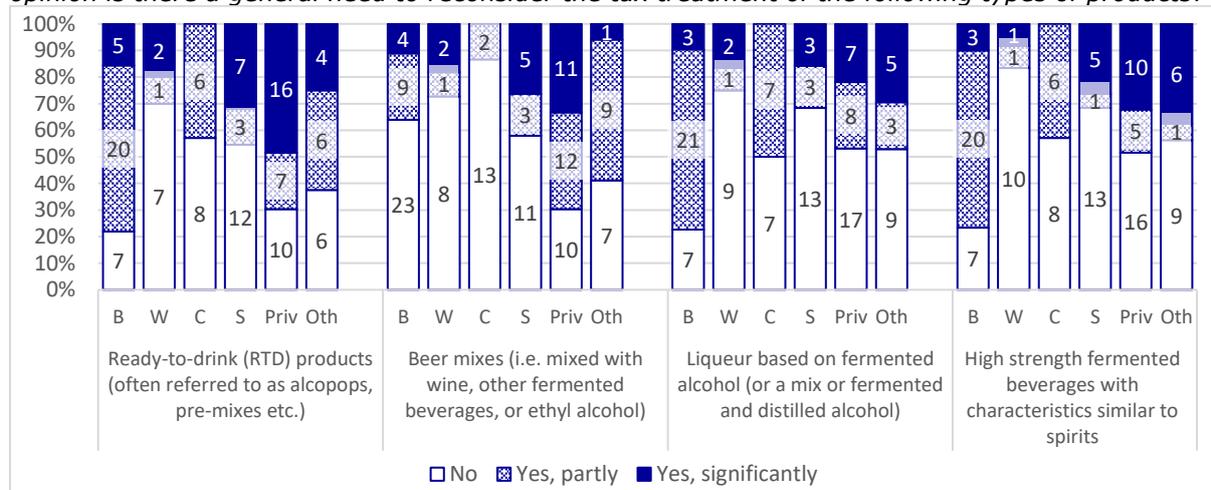
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<sup>366</sup> REFIT Platform Opinion on the submission by the Scottish Council for Development and Industry and a Member of the REFIT Platform Stakeholder group on the common interpretation of EU laws on Wine and Spirits Date of Adoption: 07/06/2017.  
<https://ec.europa.eu/info/sites/info/files/xviii12abinterpretationeulawswine.pdf>

<sup>367</sup> Reported by DG TAXUD on 02.10.2017.

**Figure 21 – OPC results for Question #13**

Q13: The current classification rules may create situations where certain new beverages may be placed on the market at a relatively affordable price, due to a favourable tax treatment. In your opinion is there a general need to reconsider the tax treatment of the following types of products?



Source: OPC.

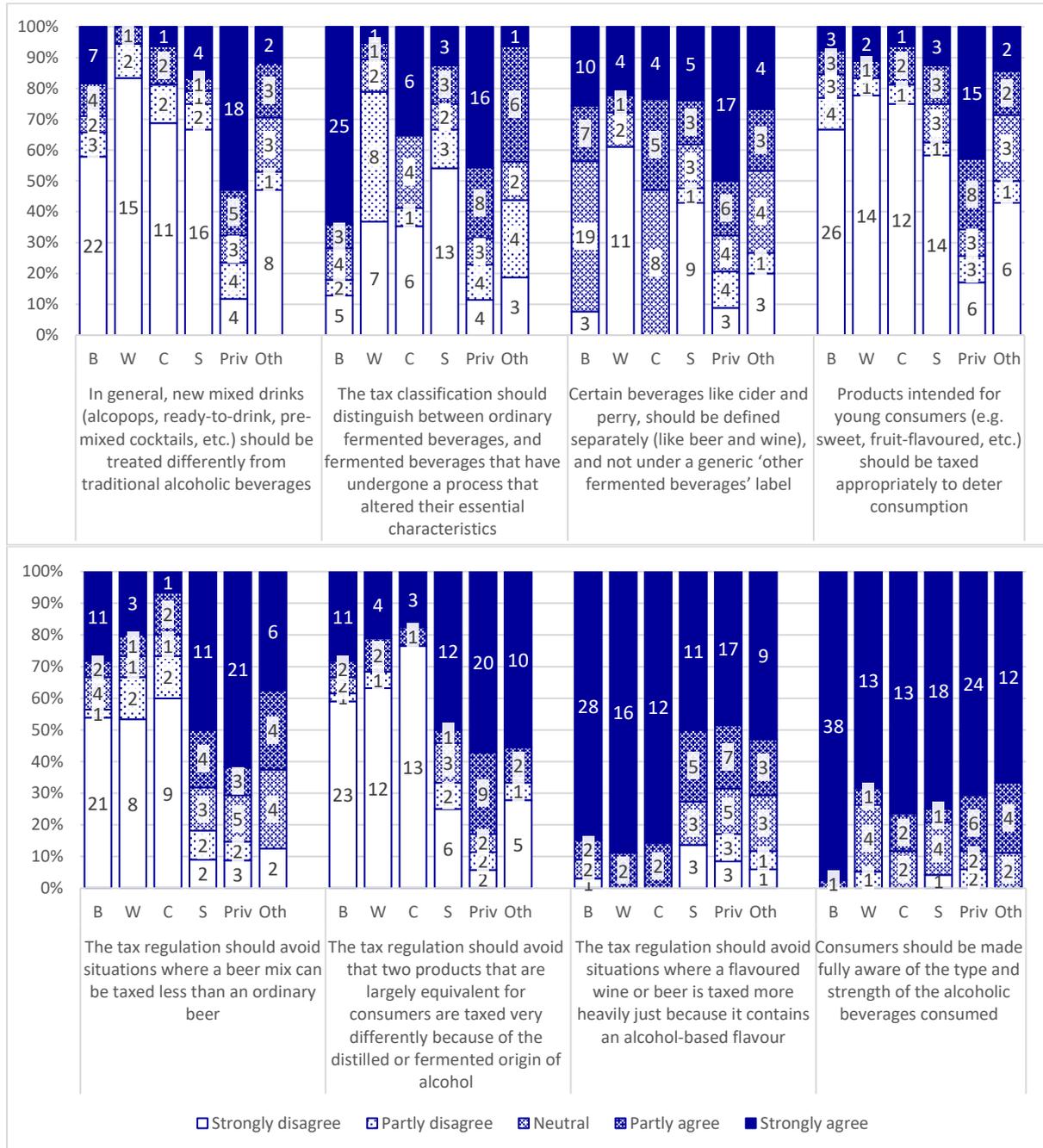
Legend: B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

Note: producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

To conclude, it is also interesting to briefly review the stakeholders' position with respect to the basic principles that should guide any possible revision of the tax classification rules, as emerged from the OPC (Figure 22). A clear majority of the industry disagrees with establishing a different tax treatment for new mixed drinks, whereas private individuals tend to agree with it. Similarly, the industry opposes any special treatment of products intended for the young persons, while private individuals and some other types of respondent are in favour. Mixed views exist with respect to 'cleaned-up' fermented bases: individual respondents, the beer industry and part of the cider industry believe a fiscal distinction is needed, while the wine and spirit industries are against it. Unsurprisingly, the taxation of products that are equivalent for consumers but based on fermented or distilled alcohol divides the industry, with producers of fermented beverages (beer, wine and OFB) in favour of different levels of taxation depending on the base (fermented or distilled), and spirits producers advocating for an equal treatment, regardless of the base. At the moment, the consumers have limited information on the alcohol base (and blends) used in certain beverages, and nearly all respondents agree that consumers' awareness is a fundamental principle. Finally, all respondent groups agree that wines and beers using alcohol as flavour-carrier should not be taxed more heavily because of it.

**Figure 22 – OPC results for Question #16**

Q16: In your opinion, which principles should guide a possible revision of the tax classification of alcoholic beverages? Please express your agreement / disagreement with the following statements.



Source: OPC.

Legend: B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

Note: producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

### 3.1.2 Review the scope of the tax category for 'other fermented beverage'

#### 3.1.2.1 Definition of policy options

##### ➤ CLARIFY THE EXCISE DUTY STRUCTURE FOR 'BORDERLINE' PRODUCTS (OPTION I)

The first approach considered consists of refining the current definition of certain excise duty categories so as to reduce the risk of disparities of treatment and/or unduly favourable treatment of 'borderline' products, but without changing the five-category fundamental structure of the Directive. As discussed at length in the previous Section, the classification issues examined here regard the distinction between CN 2206 and CN 2208 and the 'subjective' criteria introduced by the CJEU jurisprudence and adopted in CNEN note 2206 00, which opened the CN 2208 heading also to beverages that are not based on alcohol from distillation. In particular, 'borderline' products include beverages based on 'cleaned-up' fermented alcohol and mixtures of alcohol of different sources and other substances, for which the essential character of a certain fermented beverage is possibly lost. In the absence of clear and harmonised criteria for establishing under which conditions this essential character (i.e. taste, smell, and appearance) is maintained or lost, each MS adopts different approaches and methods, thus resulting in disparities of treatment.

Under the current system the customs classification determines the excise duty category. Once a beverage is classified as CN 2208 it can be taxed only under Article 20 (Ethyl alcohol), while if classified as CN 2206 it may fall under Article 12 (OFB) or Article 17 (Intermediate Products) depending on its strength, but not under Article 20.<sup>368</sup> In other words, since the excise duty classification comes after the CN classification, tax administrations have limited room for manoeuvre in applying the category that they consider appropriate for products that come with a CN code they disagree with. In principle, tax administrations might challenge questionable CN coding decisions, but when these are covered by a BTI issued in another MS they generally opt for avoiding disputes. The consequence is that similar products may end up being excised differently depending on the country of origin. The problem is possibly made more acute by the fact that - according to some anecdotal evidence from interviews - products intended for cross-border trade might be subject to less controls and/or to a more flexible classification than products for the domestic market.

To redress this situation, a first possible option is to make the tax classification of these products not so strictly determined by the customs classification. The excise definition of products should evidently remain linked to the CN heading, but the criteria that today determine if a borderline product should fall under Article 20 or not could be established explicitly in the tax regulation rather than derived from the prior CN code. This approach would be *inter alia* consistent with the principle that CN codes are for 'tarification' purposes and may be inappropriate to determine the excise duty treatment of products that were not on the market when Directive 92/83/EEC was adopted.

In practice, this would translate into introducing in the Directive the same CJEU principle that currently inform CN classification, which establish that a fermented-base beverage that has lost its essential character (taste, smell, and appearance) can be assimilated to a distilled-base beverage, and excised in accordance with Article 20. This approach would require to amend the text of the Directive:

- excluding from the scope of Article 12 and Article 17 products that have lost their essential fermented character; and

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<sup>368</sup> Actually, it may fall under Article 20 if its ABV exceeds 22% vol, but this is mostly a theoretical case with no correspondences in the market.

- allowing under Article 20 products coming under CN 2206 of any ABV strength (the denomination of the category might be revised accordingly).

Under this approach, MS may consistently tax under Article 20 any 'borderline' product that is considered as having lost its essential fermented character, regardless of the fact that it comes under CN 2206, with or without a BTI. Incidentally, it has to be noted that the correspondence between the CN and the excise duty system is already 'many-to-many', so this amendment would not particularly disrupt the concordance mechanism. Ideally, this policy change may lead to:

- full coherence in the way similar products are excised in each geographical market (the tax category is no longer determined by prior CN classification decisions issued in other countries) and, by consequence, equal treatment of domestic and foreign products with similar characteristics;
- reduced need for BTIs, and possibly reduced recourse to the CN 2208 heading for non-distilled beverages – which is at present the only instrument that authorities have to pursue restrictive excise duty policies – hence more consistency in the application of this code to spirits and liqueurs.

On the other hand, this approach seems less robust in ensuring a coherent treatment of the same products across different MS. This will essentially depend on the common rules and criteria that will be established to determine when a product has actually lost its essential fermented character. The more these criteria are unambiguous, objectively-measurable and agreed among MS authorities, the lower the risk of disparities of treatment. Such criteria should not be laid down in the text of the Directive but defined in detailed operational terms in guidelines or recommendations developed by a joint technical working group and adopted at ITEG level (non-regulatory measure). This approach would have the advantages of allowing some flexibility in the concrete implementation of criteria at MS-level – in line with the specificities of national markets – and of facilitating its periodical updating. Based on the feedbacks collected these guidelines should, among other things:

- Set the maximum amount of distilled alcohol that can be added to a fermented beverage before it becomes prevalent for categorisation purposes, and this both in terms of contribution to the total ABV and/or overall volume of the end-product.
- Establish if, and to what extent, the addition of other substances like water, sugar, cream etc. may *per se* affect the fermented character of a beverage or not, and the criteria thereof.
- Establish common methods and analytical parameters to deal with 'cleaned-up' alcohol, both as an end-product or a base for other beverages. Ideally, the approach should be oriented to the final product and not to the production processes. The risks of making reference to specific procedures like reverse osmosis, cryoextraction etc. include: (i) technology evolves, and any rule linked to it may become rapidly obsolete; (ii) under certain circumstances, these processes are admitted oenological practices, and it might be considered discriminatory if they concur to categorise OFB but not wine.

The proposed guidelines would not be binding so a certain disparity of treatment across MS might still be possible, with adverse effects ranging from mere ineffectiveness against the problem targeted, to the risk of fuelling more disputes, including at international level (WTO), since the Harmonised System is broadly used to determine the tax category of alcoholic beverages also in third countries. As the BTI tool would no longer ensure the same tax treatment of a product across the EU (including imported products) any non-robust and agreed mechanism may have far-reaching negative consequence on the market.

Secondly, there is the risk that non-target products are also caught in this re-classification process. As shown in Section 2.1 certain aromatised wine products with an ABV lower than 10% that come under CN 2206 or CN 2205 are excised under Article 12.<sup>369</sup> The characteristics of some of these products may comply with the above criteria for the identification of 'borderline' products (addition of alcohol and other substances, neutral base etc.), and may therefore end up being re-directed to Article 20. Beside the evident market effect, there would be also a legal problem with those that come under CN 2205 since the proposed revision would regard extending Article 20 to CN 2206 but not to CN 2205. Moreover, unlike CN 2206 products, there is no CNEN note or CJEU judgement that would support their reclassification as CN 2208. In this Study, we consider impact on aromatised-wine products as 'unintended', meaning that these products are not in the scope of this possible regulatory revision and any expected impact would be a collateral undesired effect. However, according to various stakeholders interviewed, the advantageous tax treatment extended to certain wine-based product would not be justified since these products are in many respects equivalent to other RTDs with a fermented base.

With the exception of the case of CN 2205 'borderline' products, the risk that a product is classified inconsistently for CN and excise purposes seems negligible. In fact, if the proposed option implies more freedom in the choice of the applicable tax category, *de facto* in most countries there is no separate processes for CN and excise classification. We can assumed this would not change under the option considered, and the same staff would continue assigning the appropriate tax and customs codes in a coherent manner.

**Table 50 – Overview of impact areas of the proposed option I for classification issues**

Regulatory Option (Revision of Directive 92/83/EEC)	Impact Areas	Nature of Impact Expected
<b>Clarify the excise duty structure for 'borderline' products, expanding the scope of Article 20.</b>	<ul style="list-style-type: none"> <li>Legal certainty</li> </ul>	<ul style="list-style-type: none"> <li>Reduced risk for disparities of treatment of similar products in the same market.</li> <li>Unclear status of CN 2205 borderline products.</li> <li>More uncertainty at EU level, if the classification criteria retained are not robust.</li> <li>Related risk of disputes at international level.</li> </ul>
	<ul style="list-style-type: none"> <li>Competition and market effects</li> </ul>	<ul style="list-style-type: none"> <li>Borderline products would become excisable under Article 20, with negative impact on demand and possible substitution.</li> <li>Non-target products might be caught unintentionally.</li> <li>Risk of severe impact on trade, if the classification criteria retained are not robust.</li> </ul>
	<ul style="list-style-type: none"> <li>Tax revenues</li> </ul>	<ul style="list-style-type: none"> <li>The demand of 'borderline' products may reduce significantly so the effects on the tax revenues could be mild.</li> </ul>

#### ➤ INTRODUCING A DIFFERENTIATION IN THE OFB TAX CATEGORY (OPTION II)

The OFB excise duty category defined under Article 12 encompasses a broad range of products, in particular: (i) cider, perry and fruit wines of various kind, with or without a regulated denomination; (ii) low-strength mixed drinks, with or without the addition of alcohol, below 10% vol; (iii) other medium-strength entirely fermented beverages below 15% vol (very rare); (iv) aromatised wine products of the CN 2206 type and, in a few

<sup>369</sup> Some MS may tax them under Article 17(2) when aromatised wine products with an authorised addition of alcohol and an ABV of 7-10% vol.

cases, of the CN 2205 type, below 7% vol. The OFB category was primarily designed for cider, perry and fruit wines issued of agriculture, while the other products have emerged more recently as a result of innovative production processes, evolving consumers' preferences, and market opportunities. The favourable tax regime extended to OFB clearly had a role in it, although perhaps not always prominent (see Section 2.1.4). In order to restore the original principles and market equilibrium and/or to respond to social demand of higher protection against the risk of alcohol consumption among young people, various MS have then introduced differentiations within this category. In a nutshell, two different approaches exist:

- (i) to distinguish for tax purposes traditional cider and other products defined in country-level sectoral legislation, from all other generic OFB, including 'mass-market' cider and the like (e.g. Ireland, Romania, Poland, UK, France);
- (ii) to apply additional consumption taxes on specific categories of mixed drinks to deter their consumption (e.g. pre-mix tax in France, alcopop tax in Germany<sup>370</sup>, Luxembourg and Denmark).

A third approach, with similar intent and effects, selected by other countries (e.g. Italy), does not imply additional national measures but consists in the adoption of the optional provision of Article 17(2) that allows to categorise as Intermediate Products (IP) also OFBs with an ABV in excess of 5.5% vol (8.5% vol for sparkling OFB) that are not entirely of fermented origin. In some respect, this is tantamount to a differential tax regime for certain mixed drink with an ABV of 5.5% - 10% vol.

These approaches evidently respond to specificities of national markets and needs, and the actual tax differential ranges from relatively modest differences (e.g. Poland, and to some extent Ireland) to major ones (Denmark, Luxembourg, Romania). A review of relevant examples is provided in Table 51 below.

**Table 51 – Differential tax treatment of certain type of OFB across selected MS (end 2016)**

Member State	Standard excise duty (€/hl)	Differential regime (€/hl)	Difference (in %)
<b>France</b>	<b>€3.77</b> (still OFB)	<b>€1.33</b> (cider, perry, hydromel, slightly fermented grapes juice) <b>+ €110 per litre of pure alcohol</b> (pre-mixes)	<b>-64%</b> (cider, perry, hydromel, slightly fermented grapes juice) <b>+304%</b> (pre-mixes – estimated on a drink of 7% vol)
<b>Denmark</b>	<b>€71.58</b> (still OFB <= 6%) <b>€115.62</b> (still OFB > 6%)	<b>+ €96.00</b> (mixture with non-alcoholic drink <=10%) <b>+ €154.00</b> (mixture with non-alcoholic drink >10%)	<b>+ 134%</b> (mixture with non-alcoholic drink <=6%) <b>+ 83%</b> (mixture with non-alcoholic drink 6-10%) <b>+ 133%</b> (mixture with non-alcoholic drink > 10%)
<b>Luxembourg</b>	<b>€0.00</b>	<b>+ €600</b> (mixture with non-alcoholic drink)	<i>N/A (denominator is nil)</i>
<b>Romania</b>	<b>€89.87</b> (still OFB) <b>€10.73</b> (sparkling OFB)	<b>€0.00</b> (cider, perry, hydromel)	<i>N/A (denominator is nil)</i>
<b>Poland</b>	<b>€37.21</b> (OFB)	<b>€22.85</b> (cider, perry)	<b>-39%</b> (cider, perry)
<b>Ireland</b>	<b>€141.57</b> (OFB <= 5.5%) <b>€424.84</b> (OFB still > 5.5%)	<b>€47.23</b> (cider and perry <= 2.8%) <b>€94.46</b> (cider and perry 2.8%-6%) <b>€218.44</b> (cider and perry 6-8.5%) <b>€309.84</b> (cider and perry > 8.5%)	From: <b>-67%</b> (cider and perry <= 2.8%) To: <b>-27%</b> (cider and perry > 8.5% still)

<sup>370</sup> Actually, the German alcopop tax regards products that can be classified as 'ethyl alcohol' i.e. spirit-based mixed drink. The distinction with OFB-bases mixed drink is often blurred, however, for the analysis carried out in this Section the German case is not relevant.

		still)	
<b>Italy</b>	<b>€0.00</b> (OFB ≤ 5.5%)	<b>€88.67</b> (OFB 5.5%-10% with alcohol added – ex Article 17(2))	N/A (denominator is nil)

**Source:** Author's elaboration of EDT.

**Notes:** for a better readability of the table some further differentiations within sub-types of product are not displayed. Also the UK has a very articulated tax rate differentiation, entirely developed in the area of the reduced rates, i.e. unlike IE, PL, RO etc. there is only one standard rate for all OFB, but there are different reduced rates for products < 8.5% vol whether 'cider and perry' or 'other'.

The policy option for a revision of the Directive that is developed here consists in a possible extension of these national approaches to the EU-level, with a view to differentiate the OFB products that arguably correspond to the original definition and intention of the legislator from the 'novel' products that have been opportunistically designed to fit into it or simply that do not fit elsewhere. In fact, the two existing approaches have the same objective and the same result. The only difference between them regards which 'sub-category' is separately defined and excerpted from the standard one – i.e. the 'mixed drinks' (intended as 'pre-mixes, alcopops etc.) or the 'cider and perry'. In visual terms, the two approaches can be represented as in Figure 23 below, where their difference concerns where the demarcation line is drawn, namely:

- **Line A:** cider and perry (and specific OFB like mead, hydromel, certain fruit-wine etc.) v. Other OFB (including mixed drinks and possibly certain 'borderline' cider drinks).
- **Line B:** mixed drinks (pre-mixes, alcopops and the like) versus cider, perry and any other non-mixed OFB of any kind ('traditional' or not).

**Figure 23 – The two possible approaches for differentiating the OFB category**



With the only exception of France - where both differentiation lines are in place - all other MS have opted for either of the two distinctions. This is also the approach chosen in this Report, since introducing two differentiations at the same time would excessively fragment a category that is currently the smallest. The two approaches are in many respects equivalent and since *a priori* there is no strong element to select one, both solutions are examined here – i.e. 'Line A' and 'Line B'. To combine the two approaches in one model and standardise the analysis, it is assumed that on the left side of the demarcation line (with reference to Figure 23) stands the OFB that would remain under the standard treatment envisaged by Article 12, while on the right side stand the products that would qualify for a separate tax treatment. As concerns the regulatory changes required:

- The demarcation Line A would require to adopt at EU level a harmonised definition of cider, perry and the other OFB that correspond to the original scope of this category, matching as much as possible with the existing national definitions for these products. As discussed in Section 2.1.4 this is far from being straightforward: national definitions may vary significantly; the industry calls for a permissive approach e.g. establishing no minimum amount of fresh juice, no limits to added sugar and water etc. – which is probably tantamount to shifting Line A rightward to overlap with Line B; whereas certain consumers organisations consider most of the mass-market products not to be 'real' cider. The Directive is clearly not the appropriate vehicle for product definition, which should instead be developed as sectoral legislation.
- The demarcation Line B would require to define what a mixed drink is and the relevant criteria to allow for such a categorisation. Also in this case various

approaches exist and an agreement should be reached among MS at the expert group level. The French definition seems more all-catching than other mixed drinks definitions in that it applies either to mixture of different beverages or to beverages with a certain amount of added sugar/sweeteners. In this respect, it may encompass also various 'borderline' ciders<sup>371</sup> - which means Line B would shift leftward to nearly coincide with Line A. In this respect, it is worth reminding that a previous attempt to define 'alcopop' at EU-level was dropped.<sup>372</sup>

In both cases, the two demarcation lines may shift to the point of overlapping. In analytical terms, this means that the market impact of the two approaches differs primarily with respect to the treatment of 'borderline' cider, i.e.: (i) on the left side of the demarcation line - approach B, but also 'permissive definition' under approach A; or (ii) on its right side - 'restrictive' approach A or extensive (France-like) approach B.

Developing detailed product definitions and establishing their appropriate tax treatment is not in the scope of this work, however for the further development of the impact analysis it is necessary to formulate assumptions on the possible tax level that would apply to the new category that has been imagined. In fact, the differentiation would have tangible effects only if a tax differential is introduced, as it is currently the case in the MS listed in Table 51 above. In this Study, we have hypothesised that the new category would be treated tax-wise the same way Intermediate Products are treated. This assumption seems consistent with the fact that Article 17(2) already envisaged the possibility to treat as Intermediate Products certain mixed drink with added alcohol with a strength of 5.5%-10% vol. This approach is also less disruptive, in principle, than certain national mixed drinks taxes (e.g. FR and LU) which *de facto* make certain products commercially non-viable. In this sense, a 'variant' of the policy option described here could be to simply subsume the newly defined category of product under Intermediate Products (Article 17). This would certainly simplify technical and administrative arrangements. However, it is not our preferred choice because:

- (i) It would excessively tie the hands of national administrations to a certain regime, limiting their ability to customise the treatment of these products to their needs and market conditions. It is useful to remind that only a minority of MS have adopted these differentiation, so it is possible that some of them are not interested in different tax levels. The assimilation to the IP category, would impose to these products at least the minimum rate envisaged in the Directive (EUR 45 per hl). Other MS have instead adopted much higher tax levels than the IP, and would probably oppose lower rates.
- (ii) Assimilating these OFB products to IP may have adverse consequences also for the non-target IP products like fortified wines, certain vermouths etc. In the attempt to modulate an appropriate treatment of mixed products MS may eventually establish IP rates that are higher than the rates they would have applied if the IP category contained only fortified wine and vermouths.
- (iii) The IP excise duty structure is a flat rate per hl of finished products, regardless of alcoholic strength. In practice, the near totality of IP's are comprised between 10%-22% vol and often closer to the high-end. Applying this structure to mixed drinks would mean to extend it to products of lower strength, even below 5.5%. As described previously, below 10% vol the IP excise duty is generally the highest, often much greater than the Ethyl Alcohol duty.

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<sup>371</sup> This might explain also why their market is so small in France as compared to other MS.

<sup>372</sup> COM(2017) 58 final.

The last point raises a more general question on how to establish this tax avoiding distortions or creating unintended incentives, especially as regards very low-strength products. The issue may be circumvented by allowing the application of reduced rates for products below a certain threshold (or falling into different ABV bands).

The products considered here are typically low-strength. As shown previously (see Table 14), an estimated 88% of mixed drinks have an ABV lower than 10%, and also 'borderline' ciders are typically below this level. Similarly, pre-mix and alcopop national taxes target products below 10-12% vol, so on the one hand it would be logical to fix the scope of the new category to this ABV band. However, this could create again distortions and unintended incentives vis-à-vis products with a higher ABV, in the event MS fix the rate applicable to the new category above the IP level. Taxing the new category per pure alcohol would easily solve all risks of distortion, but it would contradict the current structure of OFB that is – as wine – per volume of finished product, and any revision of it is beyond the scope of the present exercise. To sum up, in our scenario analysis we have considered the new category applicable to products up to 22% vol, although in practice a tangible market effect can be registered only for products below 10%.

In terms of market effects, this approach may have a few unintended effects to be considered. First of all, as seen, the OFB category includes also certain aromatised wine products (both of CN 2206 and CN 2205 types) that might be caught in the definition of the new category. Secondly, the status of mixed beer would remain uncertain. At the moment they are classified as CN 2206 but taxed under Article 2 (beer). The French pre-mix tax applies to beer mixes as well (but not to product of CN 2205 category), but at EU level this would require a revision of Article 2 that is not in order. The results could be a significantly more favourable treatment for e.g. a flavoured beer-mix than for a flavoured-cider-mix. Similarly, the status of spirit-based mixed drinks would have to be considered: at the moment they may suffer from the more favourable treatment granted to OFB-based mixed drinks, but if they remain outside of the new category, there would be a reverse tax incentive to produce low-strength spirit-based drinks (taxed by pure alcohol) than fermented-based drinks (taxed by volume of finished product). If the Line B approach is taken, this could be easily solved by including CN 2208 products in the new category (in line with French model); in the case of Line A it would be more complex, since there would be no explicit definition of what falls right of the demarcation line.

The risk that inappropriate or weak definitions create incentives to develop new 'borderline' products or to fuel tax-induced substitution cannot be excluded, and is roughly proportional to the tax differential applied between the two sub-categories established and the difficulty to enforce the classification criteria retained. Too permissive criteria, may have the opposite effect of prompting the development of 'borderline' OFB beverages that are today kept at bay by the subjectivity of criteria. In other words, the uncertainty of classification induces a cautious attitude among producers towards stretching the criteria beyond a certain limit. If a permissive definition of OFB (or cider, perry and other specific OFB) is adopted, this may possibly encourage economic operators, including those who currently produce 'genuine' OFB to adjust their standard to the minimum legal requirements. Of course, it is possible to elaborate robust definitions that prevent this risk. Some of the national taxes examined (e.g. the French pre-mix tax) do not reportedly present problems of this kind.<sup>373</sup> The considerations made previously on the need to develop agreed definitions involving all MS administrations (in consultation with industry representatives) also apply here.<sup>374</sup>

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<sup>373</sup> Instead, the Romanian differentiation between 'legal' cider and other OFB resulted difficult to enforce, since 'mass-market' products are imported under the 'cider' heading and are therefore placed on the market as if they were 'traditional' cider (at zero rate). This problem would not be relevant in case the definition of cider is adopted EU-wide.

<sup>374</sup> This is especially important for the definition of cider, for which various diverging national definitions exist.

Finally, it has to be considered that establishing a new category would inevitably imply some administrative burden, primarily related to the update of all national systems, both on the administrations and economic operators' sides. It would also become important to reconsider the current structures of EPC with a view to separate wine from the revised OFB categories (see Section 3.1.4 below).

**Table 52 – Overview of impact areas of the proposed option II for classification issues**

Regulatory Option (Revision of Directive 92/83)	Impact Areas	Nature of Impact Expected
<b>Introducing a Differentiation in the OFB Excise Duty Category, by defining separately:</b> <b>a) cider, perry and other specific OFB, or</b> <b>b) mixed drinks.</b>	<ul style="list-style-type: none"> <li>Legal certainty</li> </ul>	<ul style="list-style-type: none"> <li>Reduced risk for disparities of treatment of similar products across the EU.</li> <li>More uncertainty, if the elaborated definitions are not robust.</li> </ul>
	<ul style="list-style-type: none"> <li>Administrative burden</li> </ul>	<ul style="list-style-type: none"> <li>Need to legally and technically review the excise duty system in place.</li> </ul>
	<ul style="list-style-type: none"> <li>Competition and market effects</li> </ul>	<ul style="list-style-type: none"> <li>Increased harmonisation (reduced need for MS-level measures).</li> <li>A share of OFB (mixed drinks and possibly some 'mass-market' cider) would be taxed differently, with negative impact on demand and possible substitution.</li> <li>Non-target products might be caught unintentionally.</li> <li>Risk of unintended incentives to substitutes.</li> <li>Possible distortions due to the per volume nature of the tax envisaged.</li> </ul>
	<ul style="list-style-type: none"> <li>Tax revenues</li> </ul>	<ul style="list-style-type: none"> <li>The demand of certain OFB may reduce, with effects on the tax revenue.</li> <li>The demand of less-taxed substitute products may increase.</li> </ul>

### ➤ NON-REGULATORY OPTIONS (OPTION III)

In addition to the regulatory changes described above, there are various measures to address the identified problems, which do not require a revision of the Directive. For these options we have not carried out a fully-fledged impact assessment, since they go beyond the scope of the current revision process and the level of uncertainty due to external factors is significant. However, it is important to take them into account in the analysis, since they represent alternative courses of action that policy-makers may consider to tackle classification issues. These measures are not strictly alternative to the regulatory options, but rather complementary. Actually, some of them seem a pre-requisite for a successful implementation of the proposed Directive amendments.

The four measures presented below would require the engagement of other Commission's services and therefore need to be examined and refined at the inter-service level. Their development would ideally require an active involvement of the indirect tax service, since they would have major impacts on the functioning of Directive 92/83.

**a. Review of CN / CNEN (option III.a).** First and foremost, a significant share of stakeholders met during the fieldwork, tax authorities in particular, would be in favour of clearer common criteria for the identification of products that have lost their essential fermented character, than those laid down in CNEN note 2206 00, which reportedly leave a margin for subjective interpretation too ample. In fact, a proper clarification of the CN classification rules is a pre-requisite for the success of any intervention on excise duty structures. Furthermore, CNEN note 2206 00 is not binding, and this further increase the risk of disparities of interpretation. The first policy option analysed in this Section envisages to 'by-pass' this problem by partly

de-linking the two systems. But introducing in the Directive the principles of the CJEU jurisprudence still requires to address the current ambiguities of the CN codes, since the CJEU criteria were established in the framework of customs and not excise duty classification disputes. In this sense, it would be easier and more effective for harmonisation that such clarifications are adopted at the level of CN or CN explanatory notes. A robust distinction between fermented alcoholic products that may fall under CN 2206 and those that should be considered CN 2208 would mostly pre-empt the need for any revision of the Directive. Needless to say, the matter is outside the remit of excise duty authorities, and should be addressed at the level of Customs Code Committee, and in the relevant international fora. It has been reported that the relevant Commission service is already working on a draft text that would revise the CN code in this sense and establish binding classification rules for the products currently covered by CEN note 2206 00.

**b. Adoption of guidelines (option III.b).** The need for detailed guidelines to precisely define and categorise certain 'borderline' products is common to all solutions proposed. In fact, the regulatory option (I) discussed above requires that the CJEU 'subjective' criteria are translated in clear operational terms through a non-binding document accompanying the Directive revision; the regulatory option (II) also requires that clear, measurable and agreed criteria are adopted (through guidelines) to distinguish the 'special OFB' category from the rest of OFB; also non-regulatory option (III.a) may benefit from detailed guidelines for the practical implementation of the rules laid out in the CN notes. Nonetheless, the adoption of guidelines may be also beneficial 'per se', and in the absence of any other regulatory or non-regulatory measures. As discussed above, guidelines should, among other things:

- Establish the criteria to differentiate between a 'genuine' fermented beverage and a beverage that has lost its essential character and should be therefore classified otherwise.
- This may include setting a threshold for the amount of distilled alcohol that can be added to a fermented beverage both in terms of contribution to the total ABV and/or overall volume of the end-product, as well as other parameters related to the appearance and taste of the product.
- Since various criteria and parameters concur to determine the classification of 'borderline' beverages, guidelines should also indicate how to weigh and balance the different aspects.
- Establish if, and to what extent, the addition of other substances like water, sugar, cream etc. may *per se* affect the fermented character of a beverage or not, and the criteria thereof.
- Establish analytical parameters to deal with 'cleaned-up' alcohol, both as an end-product or a base for other beverages.
- Define common analytical methods to assess the composition of products in order to improve detection capacity and reduce uncertainties in laboratories' outcome.

The development of guidelines requires a collaborative process involving tax and customs authorities of the MS (in most MS there is no separate process for customs and excise duty classification) and the relevant Commission services. The process could be supported through funding programmes like *Fiscalis 2020* or *Customs 2020*, and involve exchanging views and experiences on the existing national measures, with a view to identify appropriate common criteria and practices that can be adopted and promoted at EU-level, also in the absence of a revision of the Directive.

**c. Sectoral regulation for cider and other specific OFB (option III.c).** Another option to consider envisages adopting at the EU-level a harmonised definition of cider, perry and other specific OFB to distinguish them from other generic OFB like

mixed drink, which are arguably taking advantages of the blurred boundaries of the current excise duty definition. This measure would be essential in the case of regulatory option (II) above, but it would be also useful as an alternative to a formal amendment of the Directive, in particular to complement the measures described in point (III.a) and (III.b) above.

The Directive on excise duty structure is evidently not the appropriate vehicle for introducing a product definition and establishing the permitted ingredients and production processes. Conversely, this should be done ideally within sectoral legislation – although the participation of tax authorities is recommended, since the matter have evident fiscal implications. In an initial stage, the adoption of a pan-EU industry code of practice may offer a useful, initial starting point to move from a non-binding to a properly regulated framework.<sup>375</sup> However, attention should be paid to how permissive or restrictive the adopted definitions are with respect to the current market situation and the future perspective. An excessively permissive definition might *de facto* open the Article 12 to any kind of OFB and make difficult to distinguish for tax purposes genuine and ‘borderline’ products. This is *mutatis mutandis* the case with Regulation 251/2014, based on which there is limited room to distinguish for tax purposes certain traditional aromatised wines from so called ‘wine coolers’ and the like. Conversely, restrictive definitions would end up covering only a small share of the current OFB market and the bulk of ‘mass-market’ would fall outside of it, so the utility for tax classification purposes would be limited.

- d. Enhance monitoring and control (option III.d).** The findings of the fieldwork conducted in a sample of MS showed that tax authorities have often a limited market intelligence of novel ‘borderline’ products. Disaggregated data per sub-category of products are generally unavailable and when products fall in a non-taxed category (such as OFB and wine in various MS) many tax administrations reported to have no data at all on sales and consumption levels. Customs may in principle have access to more detailed market statistics by 6-digits HS subheadings or 8-digits CN subheadings, but these are seldom systematised and analysed. In theory, with the exception of zero-tax products entirely outside of the excise system, it would be technically possible to reconcile the volume and value of the various sub-categories of products in a granular way, but it is not currently done, so public authorities (and other stakeholders) lack the essential monitoring data to address problems effectively and consistently.

In essence, this measure would require to introduce for statistical purposes a collection of data on excise goods volumes more granular than the current one that is articulated only on EPC, and does not cover zero-rate products. However, since procedures and administrative arrangements vary across MS a *one-size-fits-all* approach is not in order, and concrete solutions should be discussed at first at the level of ITEG group.

### 3.1.2.2 Impact analysis

#### ➤ LEGAL CERTAINTY

The fundamental rationale for the policy options analysed here is the need to reduce the existing legal uncertainties and disparities of interpretations with certain products that we have labelled as ‘borderline’ since their classification as CN 2206 or CN 2208 is not straightforward and/or coherent across countries. The baseline assessment showed that the legal uncertainty problem was particularly acute in the aftermath of the CJEU

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<sup>375</sup> The industry association AICV has reportedly initiated such a process.

landmark rulings, due to the introduction of subjective classification criteria of difficult interpretation, but overtime the extent and the frequency of concrete issues have diminished since (some) national customs have adopted rules and procedures to effectively operationalise these criteria. These include for instance the adoption of thresholds for the amount of alcohol of distilled origin that can be added to a fermented base (both in volumetric and ABV terms), as well as methods and parameters to assess organoleptic characteristics and intended use. Nonetheless, as the national approaches are non-harmonised at EU-level there remains the risk of different / incoherent legal interpretations and ensuing disputes, as well as incentives to continue to develop products exploiting these classification uncertainties.

All the policy options described in the previous Section 3.1.2.1 are intended to reduce legal uncertainties and increase the alignment of MS approaches towards 'borderline' products. The effectiveness of the measures proposed in tackling the diverse risk and adverse effects of classification uncertainties appears however uneven, as briefly summarised in Table 53 below. In particular:

- A **clarification of the excise duty structure** (option I) by introducing the CJEU criteria in the definition of certain alcoholic products may reduce the cases of similar products that are taxed differently because of different underlying CN codes attributed by different MS (with / without a BTI decision). This benefit would materialise only if the introduction of these criteria is supported by robust and agreed guidelines for their operationalisation, otherwise the current CN code uncertainties would simply be replicated to the excise duty level, and the risk of more severe legal disputes may increase.

Since guidelines would necessarily leave a certain room of interpretation to MS authorities, this option would be comparatively less effective in ensuring a harmonised treatment of the same products across different MS. The BTIs would no longer determine the applicable tax category, so their use would likely reduce. But the absence of this practical instrument may eventually trigger among economic operators the perception of a higher degree of classification uncertainty and unpredictability.

Furthermore, the possibility of mismatches between CN and excise duty classifications and in particular the fact that a product coming under CN 2206 can be taxed under Article 20 (Ethyl Alcohol) – although quite unlikely – may have unpredictable negative implications for international trade. These could be avoided if clear and coherent rules for the operationalisation of CJEU criteria are simultaneously implemented for both customs and excise duty classifications.

- The introduction of a **differentiation in the OFB category** (option II) to separate either cider etc. or mixed drinks from the rest of OFB, may ensure a more consistent treatment of certain products across MS since it would make unnecessary the current national-level distinctions and *ad hoc* taxes. Needless to say, the benefit would materialise only in the presence of a robust and agreed definition for the new category.

This may be particularly complex to achieve in the case of a separate new category for cider and other specific OFB (the 'Line A' approach described in Section 3.1.2.1), since there are (i) relevant disparities in the legal definitions that already exist at MS-level, which should be aligned; and (ii) diverging views between producers of 'mass-market' products and their trade associations, and small 'traditional' producers and certain consumers' organisations. Furthermore, with some exceptions (e.g. IE, UK) these products are typically regulated in national food & agriculture legislation, so the excise duty Directive seems not the most appropriate vehicle for establishing a

common product definition. But at the same time, there might be limited rationale to pursue an EU-level definition of cider etc. outside of its fiscal treatment.

In the case of mixed products (the 'Line B' approach described in Section 3.1.2.1), the main challenge would consist in adopting a definition that does not simply create tax incentives to develop substitute products, as it happened for instance with the 'alcopop' tax in Germany. On the scope of this category, MS may have different views related to the specificities of the national industry and market and might want to include or not malt-based mixed beverages and so called 'wine-coolers'.

Overall, the policy option would not affect the frequency of cases where similar products have different tax treatment in the same MS, due to prior diverging customs classification, and no relevant impact on disputes is anticipated.

- **Measures not involving a regulatory revision of the Directive**, and in particular the review of CN / CNEN and the adoption of guidelines for the interpretation of CJEU criteria (options III.a and III.b) would be generally welcome by competent authorities and part of stakeholders, since they may improve both the coherence in the way a single product is taxed in different countries and the consistency in the categorisation of products with similar characteristics. The incentive to pursue tax optimisation strategies by developing 'borderline' products would be reduced, and the same would likely happen with classification disputes. On the negative side, the risk of non-robust definitions or non-compliance (given the voluntary nature of guidelines) may constrain the effectiveness of this approach. The tax categorisation would remain determined by the CN code, and non-harmonised national measures for special products may persist or even accelerate.

Introducing an EU-wide regulation of cider and other specific OFB (option III.c), if not accompanied by corresponding fiscal measures would evidently have limited effects on the issue at stake, since compliant and non-compliant products would continue be taxed likewise.

As discussed, the implementation of these measures fall outside of the remit of the excise duty system, and would ideally require a larger consensus at the international level, in order to avoid any hurdles and uncertainty affecting the international trade.

**Table 53 – Summary of the expected impact of the proposed policy option on legal certainty**

Type of impact	I - Clarification of the excise duty structure for borderline products	II – Introduction of a differentiation in the OFB category	III – Non-regulatory revision options
<b>Availability of clear rules and criteria to properly categorise borderline products.</b>	<ul style="list-style-type: none"> <li>• A precondition is the adoption of robust and agreed guidelines.</li> <li>• The impact is minimal for MS that have already adopted standard operating procedures (SOPs) and the like.</li> </ul>	<ul style="list-style-type: none"> <li>• Agreement on common definitions seems complex, especially for cider.</li> <li>• Linking tax structure to external sectoral legislation may have legal implications.</li> </ul>	<ul style="list-style-type: none"> <li>• Intervention at the level of the CNEN would be more relevant and effective since uncertainties relates to customs classification.</li> <li>• Guidelines may be useful even in the absence of a Directive review.</li> </ul>
<b>Frequency of cases where the same product is treated differently tax-wise in different MS.</b>	<ul style="list-style-type: none"> <li>• There remains the possibility of disparities in the application of agreed criteria (subjective dimensions would persist).</li> <li>• BTIs would count less for tax categorization, so there is a high risk of perceived uncertainty on</li> </ul>	<ul style="list-style-type: none"> <li>• Major positive impact, since it is assumed that current existing ad hoc measures would be no longer necessary.</li> <li>• A certain risk of disparities of classification would remain.</li> </ul>	<ul style="list-style-type: none"> <li>• Clarification of the CN classification rules may reduce these cases.</li> <li>• Similar positive impact of guidelines, if robust and agreed.</li> </ul>

	the side of the industry.		
<b>Frequency of cases where similar products have different tax treatment in the same MS, due to the prior custom classification.</b>	<ul style="list-style-type: none"> <li>Major positive impact since MS have more freedom to apply the proper tax category regardless of the prior CN code.</li> </ul>	<ul style="list-style-type: none"> <li>Modest impact, since the current rules to distinguish between CN 2206 and 2208 still apply. However, the new category may attract products that would otherwise be candidate for CN 2208 (under CEN 2206 00).</li> </ul>	<ul style="list-style-type: none"> <li>Positive impact, since ideally disparities in the attribution of CN codes would be reduced significantly.</li> <li>Limited effects of non-binding guidelines.</li> </ul>
<b>Overall number of difficult to classify cases.</b>	<ul style="list-style-type: none"> <li>Limited incentive to develop new borderline product (for tax purposes).</li> </ul>	<ul style="list-style-type: none"> <li>Modest but present risk of creating new opportunities for borderline products (depending on the tax differential incentives).</li> </ul>	<ul style="list-style-type: none"> <li>Significantly reduced number, since they relate mostly to the application of customs classification.</li> </ul>
<b>Frequency of disputes with economic operators.</b>	<ul style="list-style-type: none"> <li>Less cases, but possibly more frequently of judicial nature (tax law instead of customs procedures).</li> </ul>	<ul style="list-style-type: none"> <li>Not relevant in this respect.</li> </ul>	<ul style="list-style-type: none"> <li>Reduced, in line with a possible greater clarity.</li> </ul>
<b>Trade issues at the international level.</b>	<ul style="list-style-type: none"> <li>Depending on the concrete application, the risk of trade issues at international level exists.</li> </ul>	<ul style="list-style-type: none"> <li>No significant positive or adverse effects envisaged.</li> </ul>	<ul style="list-style-type: none"> <li>Not relevant. A certain alignment at WCO level can be expected.</li> </ul>

#### ➤ COMPETITION AND MARKET EFFECTS

The re-classification of certain products under a different tax category with a different excise duty rate would clearly have an impact on the market size and trends. This impact has been assessed triangulating the results of a quantitative market analysis<sup>376</sup> econometric model with other evidence collected through interviews with stakeholders and a desk review of literature and relevant documentary sources. The various steps of the assessment and the findings are described in the following paragraphs and summarised in Table 54, Table 55, and Table 56 below.

- (i) **Step 1 – estimating the market size of potentially affected products.** This part of the exercise was conducted as part of the baseline assessment and led to the quantification of the market size of both 'borderline' products (mixed drinks and other fermented beverages that might have lost their essential fermented character) and other sub-categories of products that might be unintendedly affected since currently covered by the same Directive provisions at stake (Article 12 or Article 17). This part of the work required a detailed one-by-one analysis of a vast range of specific brand-products listed in the IWSR database. The tax treatment of these products is not disclosed so it had to be inferred from e.g. alcoholic strength, estimated alcoholic base and, in some cases, market price.

The sales volume of products with similar characteristics and falling in the same (estimated) tax category were then aggregated into homogeneous sub-categories considered relevant for the assessment. The target products include non-spirit mixed-drinks with ABV lower than 5.5% vol or lower than 10% vol, and other medium/high strength fermented beverages with an ABV up to 22% vol. Non-target products consist of certain aromatised-wine products that are possibly taxed under Article 12, including both CN 2206 and certain CN 2205 products. In practice, non-target products include product like *sangria*, *gluehwein* (mulled

<sup>376</sup> The market analysis is largely based on the results of an econometric modelling exercise conducted on the market data published by IWSR.

wine), and other aromatised-wine cocktails. We have also estimated the market of 'borderline' cider, in case it would be included in the scope of the re-classification, in line with the approach outlined in Section 2.1. Overall, it is estimated that 'target products' sales in the EU amount to approximately 154 mn litres (305 mn litres if 'borderline' cider is included<sup>377</sup>); and non-target products potentially affected to some 106 mn litres. As compared to the total volume of alcoholic beverages consumed in the EU per year, the products at stake are only a tiny minority, i.e. 0.8% of the total.

The sub-categories are defined assuming that all the encompassed products would change of tax category following the adoption of one of the policy options considered. Since the attribution of products to a certain sub-category, as well as the very market dimension of these products are subject to a certain margin of error, the baseline data used in the analysis should be taken with caution.

**Step 2 - market trends in the absence of policy changes.** This step consisted in estimating the projected value of the market after one year in the 'business as usual' scenario (i.e. dynamic baseline). Projections are based on the average growth rate observed over the past five years. We have limited the market projections assuming that growth trend is linear, and would remain similar also in the following years. The trend varies across sub-categories of product: 'borderline' OFB and IP, as well as AWP - CN 2206 are substantially stable, AWP - CN 2205 seems declining, while 'borderline' cider is growing.

The overall market change is positive, although very modest in scale. The aggregated annual variation for these sub-categories amount to less than 1.0 mn litres, which is some +0.2% per year. Needless to say, growth trends differ across the MS that have been examined and used to extrapolate general EU-level trends.

- (ii) **Step 3 - revised tax rate due to re-classification.** Option I may entail in practice that a certain amount of products with a questionable essential fermented character are taxed in accordance to Article 20. These may regard both certain Article 12 products (mixed drinks) and, more likely, certain Article 17 products - i.e. medium/high strength OFB currently considered as Intermediate Products. It is unlikely that any cider including 'borderline' ones could be affected. Also CN 2205 products would not be affected, since this option concerns only CN 2206 products. Instead, some AWP classified as CN 2206 may in theory (but not very likely) be affected. Similar outcomes could be obtained through non-regulatory options III.a and III.b.

For Option II we have not envisaged any specific tax rate, since this is outside of the scope of this exercise. However, for illustrative purposes, we have simulated that of the two categories created by splitting the current OFB category, one would retain the current Article 12 tax rate, while the other would be taxed with the same rate of IP. The simulation was conducted at the level of each of the six sample MS taking into account the different rates currently applied to OFB and IP and the existence of national non-harmonised measures (e.g. pre-mix tax, separate excise duty for cider, application of Article 17(2) etc.).

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<sup>377</sup> Where not explicitly mentioned, the figures 'borderline' cider does not include the UK market. The rationale is that since the UK market accounts alone to two-thirds of the EU cider, and is also much greater than the total market of mixed drinks, it may ultimately determine the results of the for impact assessment exercise. Secondly, in the current situation it is very unlikely that the UK would follow the EU in a re-classification process that would affect primarily the competitiveness of its domestic cider industry.

- (iii) **Step 4 - tax-induced variation of the current price levels.** An important variable of the econometric model applied is the extent to which a possible variation in the excise duty rate may translate into a variation of the average price level for a certain sub-category. This variable – denominated ‘pass-through’ factor – has been calculated for all the categories of products potentially concerned by re-classification (intended and unintended ones) based on a large matrix of historical correlation between tax (including excise duty and the VAT on the excise duty) and price levels in the six sample MS. In practice, the ‘pass-through’ factor expresses by how much the selling price of a product would change following a variation of the tax levied. It is important to remind that the tax level is only one of the possible explanatory factors behind the price level. As most of the interviewees highlighted, prices are only limitedly influenced by taxes and more importantly by marketing strategies, production costs, retail mark-ups, etc.

Fermented mixed drinks below 10% vol is the only case where no statistically-relevant correlation could be found. More than for other beverages, the price of mixed drinks seems therefore determined by factors other than the tax level. While this is the case for ordinary and modest variations of rates, in the case of special taxes (pre-mix or alcopop taxes) explicitly conceived to deter consumption, major market impacts were indeed observed, consisting in the massive withdrawal of affected products from the market. So, in the model, we have assumed for these products a conventional pass-through of 100%.<sup>378</sup>

- (iv) **Step 5 - overall variation in the demand.** The main outcome of the exercise consisted in estimating the variation of consumers’ demand of products possibly caused by the application of a different tax rate - taking into account the above effects on prices. This required in the first place to calculate the elasticity of the demand for the various sub-categories of products to re-classify. We have used for this purpose the same large dataset of Step 4. Combining the estimated variation in price levels (Step 4) and the elasticity coefficient, it was eventually possible to estimate the variation in the volumes of product demanded potentially caused by the two regulatory options at stake.<sup>379</sup> For a more accurate estimation, two different econometric models have been applied to data, which returned partly different results (but coherent in terms of general trends). As shown in Tables 56 and 57, the two models produced a minimum and a maximum impact scenario. The ‘mean’ value between the two endpoints can be taken as a valid approximation.

The assessment of impact has been conducted on the six sample MS, and the outcomes were extrapolated at EU level by applying appropriate conversion factors linked to market size. These are smaller in the case of mixed drinks, IP and AWP – where our sample accounts for some 47% of the EU market, and bigger for cider – where they represent only 14%. The principle behind

<sup>378</sup> Applying a different ‘pass through’ factor to mixed drinks, the model would evidently return different estimates. In the interim stage of the work, we had calculated the impact applying a greater pass-through coefficient (1.5 - prices increase in a greater proportion than the tax increase) and a smaller one (0.5). In the first case, the impact on mixed drinks were magnified, while in the second case they were mitigated. The two alternative coefficient used were arbitrary, so the results had little analytical significance. In the final version of the Study, we have approached the issue of sensitivity of results by using two different econometric models, and calculating an upper and a lower threshold to the estimates provided. Therefore, the less-sophisticated simulations by different values of the pass-through coefficient have been dropped.

<sup>379</sup> The ‘arc elasticity’ formula has been used in this exercise, in consideration of the fact a big variation is expected on a category of products with varying starting prices and sales quantity, and given the absence of a specific demand function for these products. In practice, as compared to basic ‘point elasticity’, the arc elasticity defines the mid-point elasticity between the two selected points and may mitigate somehow the overall effects.

extrapolation is that the sample is sufficiently representative of the entire EU market, not only in quantitative terms but also qualitatively, and in particular that the variety of preferences and trends observed in the sample sufficiently reflects the diversity of EU countries. There are a couple of limitations in this method that are worth mentioning: (i) the outcomes of the exercise aim at representing the expected EU-aggregated impacts, but do not support conclusions on impact on individual MS; (ii) the ratio between our sample and EU-level data changes if instead of volume of products (in litres) we consider the value of market (in EUR) or the amount of excise duty collected. The extrapolation of results for these other variables using the volume of consumption as conversion factor inevitably leads to minor calculation distortions that could not be entirely corrected.

The results presented in Table 54 below show that Option I would affect primarily 'borderline' IP, with a possible reduced volume of sales of ca. -36% (average value between 'min' and 'max' scenarios).<sup>380</sup> Mixed drinks of lower strength would also be affected, but at a smaller degree, since the structure of Article 20 is by pure alcoholic degree. Overall, the consumption of target products would reduce by some 42 mn litres in one year (average scenario). The collapse is mostly due to the abrupt introduction of a relatively high excise duty on products that in various markets currently enjoy a zero or very low excise duty. It is also due to the fact that the demand of these products is quite elastic, so the consumers would likely respond to a price increase turning massively to other products.

The impact of Option II would be borne in particular by very low-strength mixed drinks and – if included in the re-classification – by 'borderline' cider. The model predicts a sales drop of respectively 46% (for very low-strength mixed drink – average scenario) and 64% (for 'borderline' cider – average scenario). More moderate is the expected impact on mixed drink between 5.5% and 10% vol, which in some MS are already taxed as Intermediate Products. The aggregated market loss would be greater than under Option I, i.e. – ca. 91 mn litres, primarily due to the 'flat' nature of the excise duty that would be applied, whose burden is inversely proportional to the ABV strength.

It is important to highlight the estimated effects on non-target products. Under Option I some aromatised wine products classified as CN 2206 may unintentionally fall in the scope of re-classification. In this case, applying their corresponding pass-through factors and elasticity coefficient, we can expect a reduction of sales from ca. 36 mn litres to nearly zero. The variation would be much greater than for target products. Under Option II, the impact on non-target products would be equally profound. Adverse market effects may be registered also by some CN 2205 products currently in the remit of Article 12. Overall, the AWP segment may register a drop of -74 mn litres (average scenario), i.e. some -70% against the 'no change' scenario.

As discussed, a quantitative assessment of the impact of non-regulatory options (in particular options III.a and III.b) would be highly speculative, since these options fall outside of the remit of excise duty system and/or are non-binding in nature. Nonetheless, since these options would essentially clarify the conditions under which certain fermented beverages should be treated like spirits, it can be assumed that their impact is conceptually similar to regulatory Option I. This is even more so, since Option I *de facto* requires that operational guidelines are adopted in support to the regulatory amendment.

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<sup>380</sup> Where not specified all figures in this section refer to the average value between the minimum and maximum scenarios provided in Table 54.

**Table 54 – Estimated impacts of the proposed options on market sales volume**

Product categories	Baseline 2016	Baseline + 1 year	Range	Option I	Diff.	Option II	Diff.
	(mn litres)	(mn litres)	(*)	(mn litres)	(mn litres)	(mn litres)	(mn litres)
<b>'Borderline' OFB</b>							
Mixed Drinks (<= 5,5% vol)	73.64	74.34	max	54.62	-19.73	27.92	-46.42
			min	65.87	-8.47	51.81	-22.53
Mixed Drinks (5,5%-10% vol)	4.76	5.04	max	4.45	-0.59	4.54	-0.50
			min	4.79	-0.25	4.82	-0.22
<b>'Borderline' cider (OFB)</b>							
w/ the UK	435.27	459.44	max	459.44	0.00	97.14	-362.30
			min	459.44	0.00	221.52	-237.91
w/out the UK	151.80	153.62	max	153.62	0.00	33.80	-119.82
			min	153.62	0.00	77.08	-76.54
<b>'Borderline' IP</b>							
MHS Ferm. (10% - 22% vol)	75.49	75.48	max	40.99	-34.50	75.48	0.00
			min	54.50	-20.98	75.48	0.00
<b>Non-target products**</b>							
AWP 2205	70.12	68.15	max	68.15	0.00	29.28	-38.87
			min	68.15	0.00	24.73	-43.42
AWP 2206	36.43	36.43	max	0.50	-35.93	0,00	-36.43
			min	0.61	-35.82	5.59	-30.85
<b>TOTAL</b>	<b>412.23</b>	<b>413.07</b>	<b>max</b>	<b>322.32</b>	<b>-90.75</b>	<b>171.03</b>	<b>-242.04</b>
			<b>min</b>	<b>347.54</b>	<b>-65.53</b>	<b>239.52</b>	<b>-173.56</b>
			<b>mean</b>	<b>334.93</b>	<b>-78.14</b>	<b>205.27</b>	<b>-207.80</b>
(w/ UK cider)***	(695.70)	(718.88)		(640.75)	(-78.14)	(309.16)	(-409.72)

**Source:** Author's estimates, based on a quantitative analysis of IWSR data.

**Notes:** The 'baseline + 1 year' is estimated on the basis of 2016 data and the average growth rate registered in the past five years.

(\*) For each data point a maximum and a minimum impact is provided, based on the results of the two econometric models used in the Study.

(\*\*) Non-target products that might be affected by the policy options include aromatised-wine products (AWP) falling under CN 2206 or, in some circumstances, under CN 2205.

(\*\*\*) Since the UK cider market account for the bulk of EU cider, the impact on this market might determine alone the overall results of the exercise. For this reason, the aggregated figures containing the UK cider are provided separately.

- (v) **Step 6 - overall effects on market value.** The reduction in sales have eventually been combined with the tax-induced expected increase in prices in order to estimate the scale of the impact in terms of market value (Table 55). These are evidently negative due to the expected market decline. In both 'change scenarios' considered, the estimate loss would be around EUR 300-400 mn.

These figures have to be considered in the light of an overall EU28 market that according to IWSR amounts to EUR 207.2 bn. In this respect, the products at stake (target and non-target) represent altogether a small 1%, and the possible value loss would be of 0.2%. Also, it has to be considered that the consumption would likely shift to other products, so at systemic level the variation would be hardly noticeable.

**Table 55 – Estimated impacts of the proposed options on market economic value**

Product categories	Baseline 2016 (€ mn)	Baseline + 1 year (€ mn)	Range (*)	Option I (€ mn)	Diff. (€ mn)	Option II (€ mn)	Diff. (€ mn)
<b>'Borderline' OFB</b>							
Mixed Drinks (<= 5,5% vol)	513.45	510.30	max	387.11	-123.19	236.05	-274.25
			min	459.61	-50.69	443.94	-66.36
Mixed Drinks (5,5%-10% vol)	43.74	46.13	max	38.38	-7.76	39.02	-7.12
			min	41.63	-4.51	41.68	-4.46
<b>'Borderline' cider (OFB)</b>							
w/ the UK	2,644.07	2,790.87	max	2,790.87	0.00	732.70	-2,058.17
			min	2,790.87	0.00	1,663.81	-1,127.06
w/out the UK	473.16	478.84	max	478.84	0.00	254.95	-223.89
			min	478.84	0.00	578.95	100.11
<b>'Borderline' IP</b>							
MHS Ferm. (10% - 22% vol)	868.43	867.17	max	533.81	-333.35	867.17	0.00
			min	689.96	-177.21	867.17	0.00
<b>Non-target products**</b>							
AWP 2205	210.37	200.89	max	200.89	0.00	107.52	-93.37
			min	200.89	0.00	92.24	-108.65
AWP 2206	12.45	12.46	max	3.40	-9.05	2.85	-9.60
			min	4.19	-8.27	28.69	16.24
<b>TOTAL</b>	<b>2,121.61</b>	<b>2,115.79</b>	<b>max</b>	<b>1,642.43</b>	<b>-473.36</b>	<b>1,507.56</b>	<b>-608.23</b>
			<b>min</b>	<b>1,875.10</b>	<b>-240.69</b>	<b>2,052.67</b>	<b>-63.12</b>
			<b>mean</b>	<b>1,758.77</b>	<b>-357.02</b>	<b>1,780.11</b>	<b>-335.67</b>
(w/ UK cider)***	(4,292.52)	(4,427.82)		(4,070.80)	(-357.02)	(2,561.42)	(-1,866.40)

**Source:** Author's estimates, based on a quantitative analysis of IWSR data.

**Notes:** The 'baseline + 1 year' is estimated on the basis of 2016 data and the average growth rate registered in the past five years.

(\*) For each data point a maximum and a minimum impact is provided, based on the results of the two econometric models used in the Study.

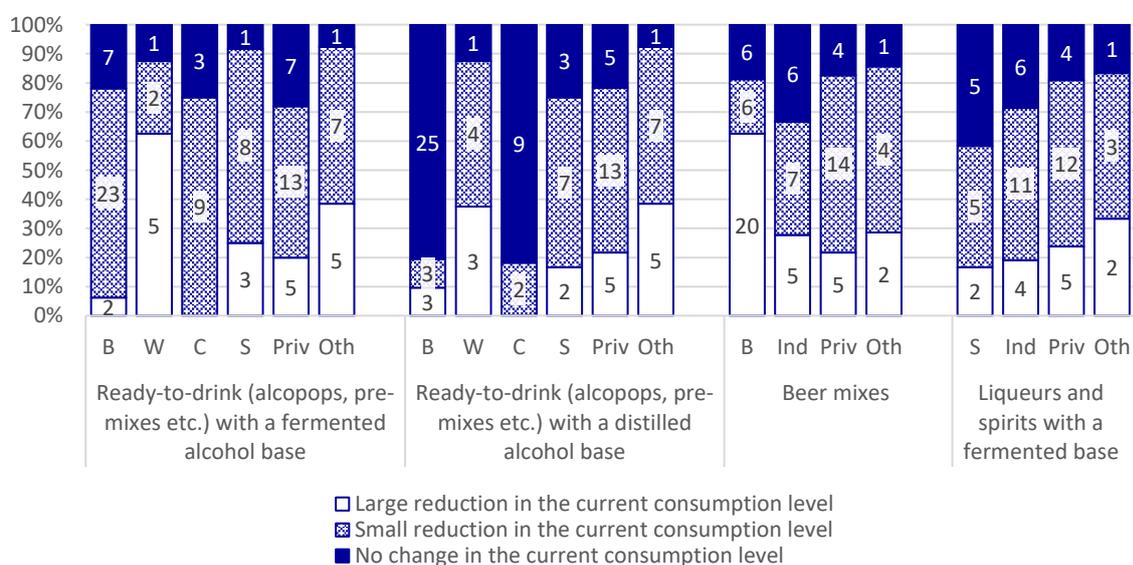
(\*\*) Non-target products that might be affected by the policy options include aromatised-wine products (AWP) falling under CN 2206 or, in some circumstances, under CN 2205.

(\*\*\*) Since the UK cider market account for the bulk of EU cider, the impact on this market might determine alone the overall results of the exercise. For this reason, the aggregated figures containing the UK cider are provided separately.

### Box 22 – Results from the OPC: expected consumer reaction to price increases

The majority of respondents believe that a price increase would generate a small decrease in consumption of all products under consideration. Rather differently from the other respondents' categories, beer industry stakeholders consider beer-mix consumers as very price-sensitive and, to the contrary, spirit-based RTDs consumers as much less influenced by price.

**Question #24** - In the event a revised taxation would increase the consumer price of the following alcoholic beverages, in your opinion what would the likely reaction of consumers be?



**Source:** OPC.

**Legend:** B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Ind: rest of the industry (not included in the previous category); Priv: private individuals; Oth: Other (public health NGOs, public authorities, etc.).

**Note:** industry stakeholders with an interest in the production or end-use of industrial alcohol have been included in the 'Oth' category (sub-questions in RTD), or 'Ind' category (sub-questions on beer mixes and liqueurs with a fermented base).

Producers and trade associations of fortified wines have been included in the wine industry group.

'Don't know' answers are not displayed.

## ➤ TAX REVENUES

The re-classification of certain products determined by the policy options analysed would have direct repercussions on the tax revenue generated. The magnitude obviously depends on the actual rates applied and the combination of two opposite effects:

- the tax yield per unit of product evidently increases when the rate increases (as a consequence of re-classification in a more heavily-taxed category);
- but the number of units sold declines, due to the negative impact of price increase on the demand.

We have further developed the scenarios described in the previous paragraphs with a view to estimate the likely net effect of policy options on tax revenues. Table 56 below compares the 'no change' scenario (baseline) with the two 'change' scenarios for the various sub-categories of products at stake, including again target and non-target products. It has to be noted that the variation of excise duty revenue is magnified by the VAT applied on it, so both estimates - with and without the VAT component effect - are provided.<sup>381</sup> The findings indicate that:

- taxing 'borderline' products under Article 20 (Option I) would result in a revenue loss of ca. EUR 126 mn / year as compared to the baseline value. The negative impact is due to the fact that the reduction in consumption would be more than proportional than the tax increase, thus offsetting any revenue benefit. Losses would be registered in particular from target products, since they currently generate much more revenue than non-target products.
- Option II may lead to even deeper losses, amounting to nearly EUR 250 mn as compared to the baseline value. However, in the event 'borderline' cider is kept out of the re-classification process, the tax gap would be 'only' EUR 35 mn. The tax gap would be particularly acute for target products, especially very low-strength mixed drinks and 'borderline' cider, due to the market collapse showed in Table 56. The loss would be partly mitigated by some extra tax revenue expected from certain non-target products.
- When compared to the EUR 35.6 bn of excise duty collected in the EU from alcoholic beverage (plus some EUR 7.0 bn of VAT on excise duty), the impact is modest, i.e. 0.3%-0.5%.

In a nutshell, in terms of tax revenue the changes analysed would likely not lead to beneficial effects. Furthermore, the only benefits would come from certain products unintendedly affected. These findings are *inter alia* consistent with the effects observed after the introduction of relatively heavy alcopop/pre-mix taxes in France and Germany: the market quickly collapsed, and in a short time period the revenue yielded from these

<sup>381</sup> The estimates including VAT refers only to the VAT applied to the excise duty and not the entire VAT paid by the product.

*ad hoc* taxes dropped to very modest amounts. Economic operators largely withdrew from the market the concerned products, since they had become too expensive for the consumers, and invested in other new products. This was for instance the case with spirits-based alcopops, which after the introduction of the alcopop tax were massively replaced with malt- and wine-based mixed drinks.

We can expect a similar process also with the two regulatory options at stake. A major tax leap would eventually result in the substitution of the target products with other products from less-taxed categories.

As discussed, the substitution effects could not be measured quantitatively, but there is evidence that consumers' preferences would largely shift to other alcoholic beverages, so the net tax loss would be mitigated. In other words, the expected reduced consumption of target and non-target products would be replaced with the consumption of products falling into other tax categories. So the ultimate effect on excise duty revenues would depend primarily on which other products would be consumed and their level of taxation. As described in the baseline assessment, in the event this substitution would follow the current consumption patterns, a minor tax loss can be expected, since the main alternatives to 'borderline' products are more lightly taxed.

**Table 56 – Estimated impacts of the proposed options on tax revenues (excise duty and the VAT applied to it)**

Product categories	Baseline 2016 (€ mn)	Baseline + 1 year (€ mn)	Range (*)	Option I (€ mn)	Diff. (w/ VAT) (€ mn)	Diff. (only ED) (€ mn)	Option II (€ mn)	Diff. (w/ VAT) (€ mn)	Diff. (only ED) (€ mn)
<b>'Borderline' OFB</b>									
MD very low	214.97	213.65	max	137.21	-76.44	-62.92	100.73	-112.91	-92.93
			min	170.86	-42.78	-35.21	213.94	0.29	0.24
MD low	7.62	8.04	max	6.48	-1.56	-1.28	5.99	-2.05	-1.69
			min	7.30	-0.74	-0.61	6.79	-1.25	-1.03
<b>'Borderline' cider (OFB)</b>									
w/UK	825.28	871.10	max	871.10	0.00	0.00	212.06	-659.04	-542.42
			min	871.10	0.00	0.00	542.48	-328.62	-270.47
W/out UK	344.24	348.37	max	348.37	0.00	0.00	73.79	-274.58	-225.99
			min	348.37	0.00	0.00	188.76	-159.61	-131.36
<b>'Borderline' IP</b>									
MHS Ferm.	224.43	225.03	max	137.17	-87.87	-72.32	225.03	0.00	0.00
			min	189.51	-35.52	-29.24	225.03	0.00	0.00
<b>Non-target products**</b>									
AWP 2205	8.15	7.67	max	7.67	0.00	0.00	37.03	29.36	24.16
			min	7.67	0.00	0.00	31.42	23.75	19.55
AWP 2206	2.61	3.78	max	0.32	-3.47	-2.85	0.00	-3.78	-3.11
			min	0.39	-3.39	-2.79	11.23	7.45	6.13
<b>TOTAL</b>	<b>802.01</b>	<b>806.54</b>	<b>max</b>	<b>637.21</b>	<b>-169.34</b>	<b>-139.37</b>	<b>442.57</b>	<b>-363.97</b>	<b>-299.57</b>
			<b>min</b>	<b>724.10</b>	<b>-82.44</b>	<b>-67.86</b>	<b>677.17</b>	<b>-129.37</b>	<b>-106.48</b>
			<b>mean</b>	<b>680.65</b>	<b>-125.89</b>	<b>-103.61</b>	<b>559.87</b>	<b>-246.67</b>	<b>-203.02</b>
(w/ UK cider)***	(1,283.05)	(1,329.27)		(1,203.38)	(-125.89)	(-103.61)	(805.87)	(-523.41)	(-430.79)

**Source:** Author's estimates based on a quantitative analysis of IWSR data.

**Notes:** ED: Excise duty (revenue); w/ VAT: excise duty augmented with the applicable VAT. The average EU28 VAT rate is conventionally applied (21.5%).

The 'baseline + 1 year' is estimated on the basis of 2016 data and the average growth rate registered in the past five years.

(\*) For each data point a maximum and a minimum impact is provided, based on the results of the two econometric models used in the Study.

(\*\*) Non-target products that might be affected by the policy options include aromatised-wine products (AWP) falling under CN 2206 or, in some circumstances, under CN 2205.

(\*\*\*) Since the UK cider market account for the bulk of EU cider, the impact on this market might determine alone the overall results of the exercise. For this reason, the aggregated figures containing the UK cider are provided separately.

➤ **ADMINISTRATIVE BURDEN**

The policy options at stake can have an ambivalent impact on administrative burden for economic operators and competent authorities. On the one hand, they are intended to cut the current unnecessary burden caused by classification issues and uncertainties, on the other hand they might result into additional costs for adapting the system and implementing the new rules. As discussed in the baseline assessment, the quantification of administrative burden is possible only on the basis of hypothetical scenarios, since there is no sufficient and reliable data to calculate real monetary costs. The simulation developed here relates to the two options requiring a regulatory amendment of the Directive, i.e. (i) the clarification of the excise duty structure for borderline products, and (ii) the introduction of a differentiation in the OFB category.

The two options are compared in Table 57 below taking into account both the beneficial impact of a possible reduction of the current unnecessary burden and the extra costs possibly required to update the existing system in line with the proposed change. It is important to consider that while the reduction of unnecessary burden is a recurrent saving, the costs to update the system are one-off, i.e. they happen only once. So the balance of costs and benefits would shift overtime. In particular, under option (I) the aggregated benefits would possibly offset costs within a 5-6 years period, while under option (II) it would likely take much longer (some 10 years or more). The distribution of impacts would be uneven: the net gains for competent authorities are much more evident than for economic operators. Finally, these estimates do not take into account the costs potentially incurred by economic operators to review their production processes, product portfolio, and market strategies in order to offset the downsides of re-classification. These are not regulatory costs in strict sense, since they do not stem from new legal requirements. However, from the perspective of economic operators they could be much greater than the sheer administrative obligations.

**Table 57 – Summary of expected impacts on administrative burden from the proposed policy options**

	<b>I - Clarification of the excise duty structure for borderline products</b>	<b>II – Introducing a differentiation in the OFB categories</b>
<b>Impact on baseline scenario</b>	<p>The policy option envisages the development of agreed and common guidelines for a more straightforward classification of borderline products.</p> <p>Depending on the clarity and robustness of the criteria and methods developed, the existing burden may be eliminated moderately or nearly entirely.</p>	<p>This policy option is less oriented toward 'difficult-to-classify' products, and the burden due to the difficult distinction between CN 2206 and CN 2208 would persist. However, it nonetheless envisages a better definition of certain OFB that might eventually reduce classification complexity.</p> <p>At the same time, every new distinction may create new 'borderline' products (in this case within the new OFB sub-categories).</p>
<b>Estimated quantitative effects (based on simulated scenarios)</b>	<p><i>Assuming the measure may reduce the number of complex dossiers by ca. 50%, the estimated costs savings may amount to some EUR 0.5 – 0.8 mn per year, for competent authorities.</i></p> <p><i>Non-quantifiable benefits for economic operators in the same proportion can be assumed.</i></p>	<p><i>All in all, the benefits of a clearer definition of certain products can be neutralised by the risk of new borderline products.</i></p> <p><i>It can therefore be assumed that the overall present burden would not change significantly (EUR 1.0 – 1.5 mn).</i></p>

	<b>I - Clarification of the excise duty structure for borderline products</b>	<b>II – Introducing a differentiation in the OFB categories</b>
<b>New administrative costs</b>	<p>This option would not impose new administrative costs beside the 'one-off' need to familiarise with the new rules and guidelines, adopt it in the standard procedures and training staff accordingly.</p> <p>Competent authorities and economic operators (in the segments touched by the revision) would be equally affected.</p>	<p>The introduction of a new tax category would require various administrative actions, namely:</p> <ul style="list-style-type: none"> <li>• Familiarisation with the new rules and guidelines.</li> <li>• Amendment of the legal and administrative framework.</li> <li>• Updating of the IT system, templates and other operational tools.</li> <li>• Training of staff.</li> <li>• Updating of the licenses and authorisation of the concerned economic operators.</li> </ul> <p>With the exception of the second point, the above costs would affect both authorities and the concerned economic operators. All the required action would be 'one-off', no relevant recurrent cost is envisaged.</p>
<b>Estimated quantitative effects (based on simulated scenarios)</b>	<p><i>The staff efforts required to familiarise and implement the new rules may vary by enterprise size. In this simulation we assumed one staff / month overall will be needed, amounting to approximately EUR 4,000 per enterprise (including overheads).</i></p> <p><i>The affected population encompasses in principle all those who produce 'borderline' CN 2206 products, these can be found primarily among OFB producers, but also among certain breweries and wine/liqueurs producers. Their precise number is unknown but assuming for analytical purposes that they are some 1,000 (cider-makers, especially 'traditional' producers would not be affected), the aggregated costs would amount to EUR 4.0 mn.</i></p> <p><i>The impact on competent authorities cannot be quantified. In terms of unit costs it is certainly higher than for economic operators, but the affected population is limited so in aggregated terms it may be modest.</i></p>	<p><i>As regards the staff efforts to familiarise and implement the new rules we estimated the same scale of impact assumed for option I.</i></p> <p><i>For the other direct costs connected to updating IT systems and tools (and the specialised expertise required), the estimates elaborated in Table 60 below for the change of the EPC seems applicable, i.e. approx. EUR 600 - 1200 per enterprise (weighted by enterprise size).</i></p> <p><i>The affected population includes primarily OFB producers (including cider-makers). However, also some producers of aromatised wine products falling in this category may be affected. Assuming an affected population of 2,000 - 3,000 enterprises, the aggregated costs would range between EUR 9.2 and EUR 15.6 mn.</i></p> <p><i>Also in this case the impact on competent authorities cannot be quantified. In terms of unit costs it is certainly higher than for economic operators, but the affected population is limited so in aggregated terms it may be modest.</i></p>

With respect to non-regulatory options (III), it is self-evident that they would not impose regulatory costs on operators and authorities directly attributable to Directive 92/83. However, the proposed measures and processes would clearly require efforts and resources in all phases of their development and implementation cycle. Since these measure fall outside of the scope of this Study precise estimates have not been developed, but some qualitative considerations are possible:

- The direct costs of the review of CN / CNEN (option III.a) are part of the ordinary activities of the appointed experts and would not represent an extra cost. On the side of economic operators and national customs offices some one-off costs to familiarise and adapt procedures to the new rules can be expected. Their magnitude would be broad in line with the expected extra costs imposed by Option I. The expected benefits are also comparable with those generated by Option I, or somehow smaller in the event CN revisions do not remove completely the uncertainties on the application of excise duty categories.

- The costs of development of guidelines to operationalise CJEU criteria (option III.b) are also an integral part of Option I scenario. They would mostly comprise the expenses for the functioning of the working group. Then, in the implementation phase, some familiarisation costs can be envisaged (but no formal act is foreseen). Also in this case, the burden reduction would be in line with Option I estimates, somehow diminished by the fact that some MS may decide not to adopt them.
- The costs of developing a sectoral regulation for cider, perry and other specific OFB (Option III.c) are difficult to estimate, since they ultimately require a fully-fledged regulatory process. In any case, these would be one-off costs, so they essentially require an initial investment to update the excise duty system and procedures. In principle, they might also increase the recurrent enforcement costs for national authorities, based on the principle that any new tax category envisages an extra monitoring and administration effort. The burden savings would be limited, since in the absence of a regulatory intervention (Option II) most of 'borderline' products would remain unaffected.
- Option III.d (enhancing monitoring and control) would have no direct effects on administrative burden, but it may be conducive to better interventions against 'borderline' products. At this stage, however, the outcome of a collaborative process on this issue is highly uncertain, so concrete benefits are unclear. On the other hand, the collaborative process would require a modest effort to the authorities concerned, which could also be funded through the relevant DG TAXUD programmes.

#### ➤ THE PUBLIC VIEW ON THE PROPOSED POLICY OPTIONS

The following Box 23 illustrates the OPC participants' feedback on the proposed policy options to address the various classification issues identified, as well as the perceived benefits and risks. Views are evidently mixed and can be easily related to the perspective of specific segments of the industry and/or interests of other nature. To highlight these differences, the responses are reported separately. It is also interesting to note that, while respondents often concede there can be added value in a general clarification of the current picture, the perceived risks of a legislative change tend to outweigh the perceived benefits across most of respondent groups (except private individuals).

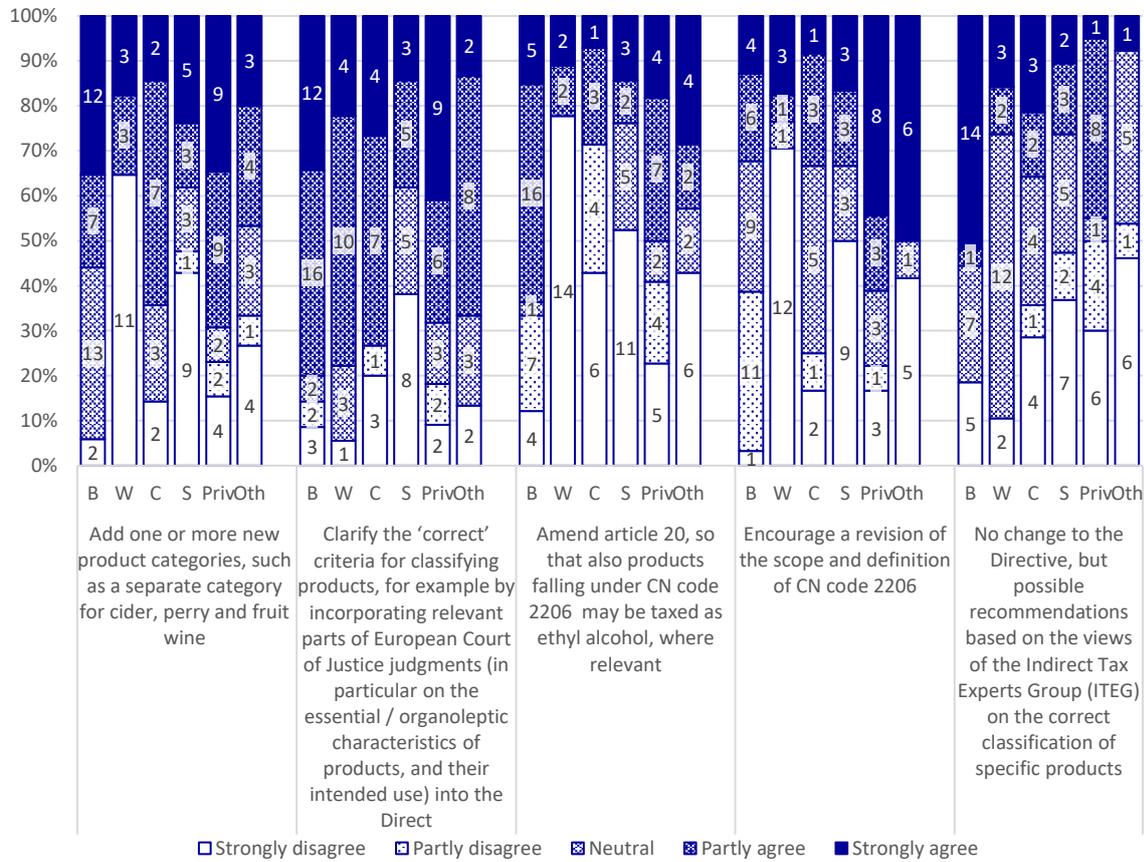
#### **Box 23 – Results from the OPC: stakeholder views on the policy options to address classification issues**

**Views on the proposed policy options.** As shown in the figure below, various different policy options were assessed in the OPC. While private individuals were in general in favour of all the options proposed, industry stakeholders had more varied views, namely:

- *Add one or more new product categories, such as a separate category for cider, perry and fruit wine.* While this option was positively received by the beer and cider industries, wine and spirits producers strongly opposed it.
- *Clarify the 'correct' criteria for classifying products, for example by incorporating relevant parts of Court of Justice judgments (in particular on the essential / organoleptic characteristics of products, and their intended use) into the Directive.* Exception made for the spirits industry, the majority of producers agreed, if not strongly agreed, with the option.
- *Amend Article 20, so that also products falling under CN code 2206 may be taxed as ethyl alcohol, where relevant.* Wine, cider and spirits producers strongly opposed this option, while to the contrary over 60% of brewers expressed an at least partial agreement with it.
- *Encourage a revision of the scope and definition of CN code 2206.* As in the previous case, this option attracted major criticism from the wine and spirits industry. Beer and cider producers were instead mainly neutral.
- *No change to the Directive, but possible recommendations based on the views of the Indirect Tax*

Experts Group (ITEG) on the correct classification of specific products. In this case, industry stakeholders expressed rather mixed views, with for instance the majority of brewers strongly in favour and over 60% of wine producers taking a neutral stance.

**Question #19** - Please express your opinion on the following possible approaches to address the problems of the definition and classification of alcoholic beverages at the EU level.



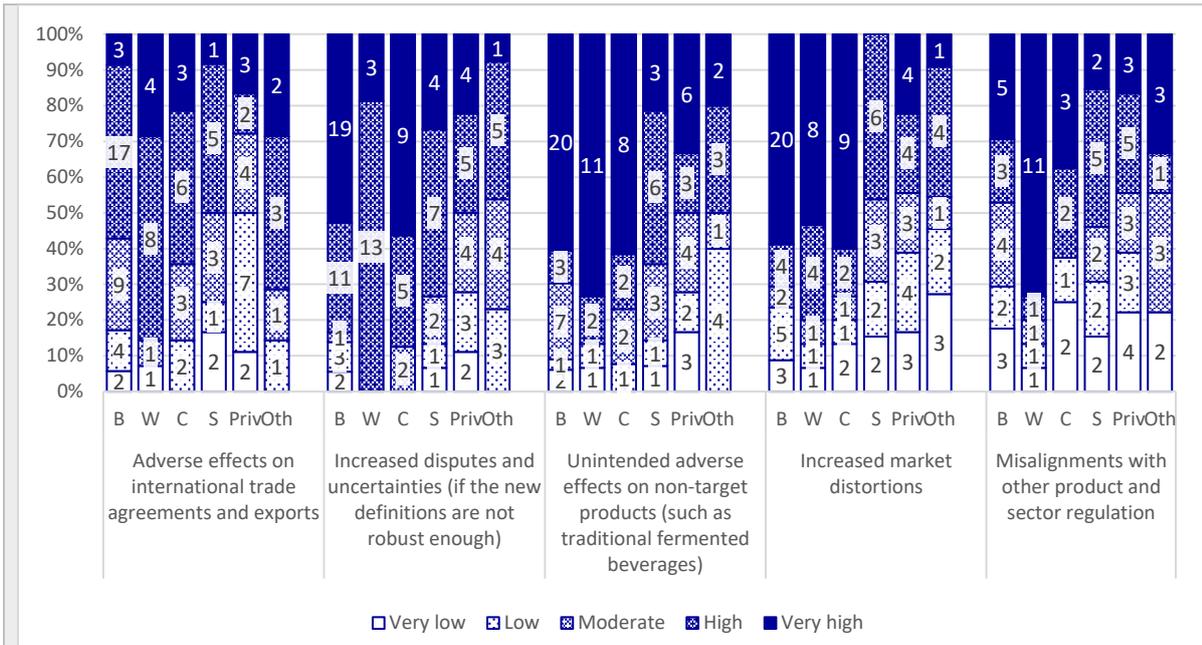
Source: OPC.

**Legend:** B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

**Note:** producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

**Perceived risks and potential benefits.** A clear majority of all industry respondents believe that a revision of the OFB tax category would generate negative effects on all fronts, including adverse effects on international trade, classification uncertainties and disputes, market distortions, etc. Private individuals and the residual 'other' category of respondents had to the contrary more mixed views.

**Question #20** - In your opinion, what are the risks of a possible revision of the tax category of 'other fermented beverages'?



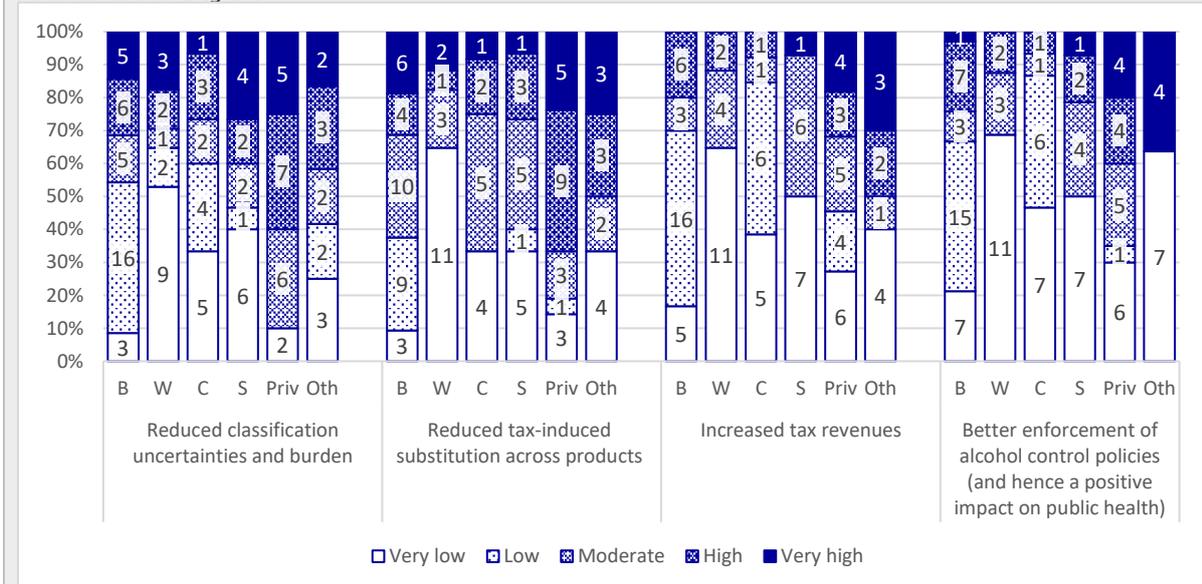
Source: OPC.

Legend: B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

Note: producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

In line with the previous question, the industry judged the benefits of a revision of the OFB tax category (e.g. reduced classification uncertainties and disputes, reduced tax-induced substitution across products) as rather low. Private individuals and the residual respondents were somewhat more optimistic.

Question #22 - In your opinion, what are the benefits of a possible revision of the tax category of 'other fermented beverages'?



Source: OPC.

Legend: B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

Note: producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

### 3.1.3 Clarify the terms 'entirely fermented origin'

#### 3.1.3.1 Definition of policy options

As shown in the problem analysis, there is an issue with the interpretation of the notion 'entirely fermented origin' used in Articles 8, 12.1 and 17 of the Directive, with respect to certain products that contain alcohol as a flavour-carrier (AFC), i.e. aromas diluted in ethyl alcohol. The amount of alcohol used for this purpose is minimal and various Member States apply a margin of tolerance for its use in certain flavoured beverages, also in line with the provisions of Regulation 1967/2005 on the use of alcohol aromas in beer, and Regulation 251/2014 on aromatised wine products. Nonetheless, a strict interpretation of the notion 'entirely fermented origin', as it is presently laid down in the Directive, would lead to a reclassification of certain AFC-containing beverages under other different tax categories.

The baseline assessment showed that the problem – if any – concerns primarily aromatised wine products, since in the case of OFB, the addition of alcohol is anyway permitted for products up to 10% vol, while the excise duty definition of beer does not contain the provision on the 'entirely fermented origin' of the products, so it is not covered by this regulatory clarification. With respect to beer, it is worth mentioning again Regulation 1967/2005, which allowed flavoured beer containing a minimal addition of alcohol to be taxed under Article 2. Analogously, according to some of the national authorities interviewed, the absence of the above provision in Article 2, can be legitimately interpreted as the possibility to tax as standard beer also the beer containing AFC.

The policy option examined here (Option IV) consists in adopting a flexible approach toward AFC, allowing the addition of ethyl alcohol of agricultural origin to products of 'entirely fermented origin' (wine and OFB), for technical purposes (to dilute or dissolve colorants, flavourings or any other authorised additives) and not exceeding the dose strictly necessary. The principle can be established in the Directive in generic terms, as in Regulation 251/2014, or setting an upper limit to the maximum contribution of AFC to the total ABV of the final products. Some MS have set it to 1.2% ABV, which is the threshold below which the excise duty on alcohol does not apply. Reportedly, other MS have used the same approach to establish a 0.5% ABV threshold to the AFC used in certain flavoured beer. The most effective approach seems a combination of the two principles, i.e. establishing that ABV should not exceed the dose strictly necessary and in any case cannot amount to more than 1.2% vol.

Although derived from the AWP regulation, the same principle should cover also OFB under Article 12 with an ABV between 10% and 15% vol, to avoid disparities of treatment. The extension of this principle to beer (Article 2) may become useful in all cases where the threshold identified in Regulation 1967/2005 is too strict (0.04% vol) and/or to harmonise MS approach to it, but since the notion 'entirely fermented origin' does not apply to the definition of beer, this revision is not strictly related to the issue at stake here.

This policy option would primarily have an impact on the certainty and consistency of rules across MS, but only limited market effects since the addition of AFC is *de iure* or *de facto* already accepted. It may be interesting however to see what is the dimension of the market (and tax revenues) at stake. The downside is evidently the risk of abuse that a permissive interpretation of 'entirely fermented origin' may encourage.

**Table 58 – Overview of impact areas of the proposed policy option on the application of the 'entirely fermented origin' provision**

Regulatory Option (Revision of Directive 92/83)	Impact Areas	Nature of Impact Expected
<b>Introducing a margin of tolerance in the notion 'entirely fermented origin' for alcohol as a flavour carrier, with or without establishing a fixed threshold.</b>	• Legal certainty	• Reduced risk of disparities of treatment across MS. • More certainty for economic operators on accepted practices.
	• Market effects	• Only for products currently or potentially excluded from this tax-break.
	• Tax revenues	• Risk of abuse, and difficult enforcement.

### 3.1.3.2 Impact analysis

#### ➤ LEGAL CERTAINTY

The evidence from the fieldwork interviews and the stakeholders consultation suggest that there are limited concrete cases of classification uncertainties or disputes related to the addition of minimal amounts of alcohol as a flavour carrier (or for similar technical purposes) to fermented alcoholic beverages.

With respect to aromatised wine products, the Regulation 251/2014 clearly states the condition for its use: *'the ethyl alcohol used to dilute or dissolve colorants, flavourings or any other authorised additives used in the preparation of aromatised wine products must be of agricultural origin and must be used in the dose strictly necessary and is not considered as addition of alcohol for the purpose of production of an aromatised wine product'*.<sup>382</sup> A beverage complying with these criteria can be considered an aromatised wine product in accordance to sectoral legislation, but this does not automatically imply that it is in line with the provisions of Article 8 and Article 12 requiring that products are 'entirely of fermented origin'. If strictly intended, this provision may require that products containing a single drop of alcohol of distilled origin are classified as Intermediate Products.<sup>383</sup> As discussed in the 'baseline assessment' the risk of inconsistencies have been addressed by various MS by either (i) adopting a flexible approach to functional alcohol added, i.e. adopting *de iure* or *de facto* the same principles of Reg. 251/2014 also for tax purposes, or (ii) setting specific maximum limits (in ABV terms) to the amount of AFC that can be added to a fermented beverage before the tax category changes (typically 1.2% vol). These measures are evidently not harmonised and vary across MS. In some of the MS examined there is no such measure in place and, in theory, the addition of any amount of AFC would trigger the IP tax treatment, but in practice a certain degree of tolerance is generally granted. So, it can be assumed that in the EU only a small fraction (not possible to quantify) of aromatised wine products containing minimal amounts of AFC are possibly taxed under Article 17.

Still, the OPC results show that a minority of economic operators from the wine sector is aware of somehow frequent issues with the classification of these products – further confirmed by the widespread support that a harmonised solution to this issue has received (see Box 24 below). In our understanding, this is not motivated by major legal disputes, severe market distortions or the like, but primarily by the degree of uncertainty that the current 'patchwork' of national solutions inevitably cause, which may create

<sup>382</sup> Regulation 251/2014, Annex I, point 3, page 28.

<sup>383</sup> Except products eligible for Article 12(1) first indent and Article 12(2) first indent (OFB below 10% and 13% vol, respectively).

unnecessary hurdles and delays in operations and eventually constrain the full deployment of the market potential. The matter seems of limited relevance for MS authorities that have adopted an explicit approach to deal with these products, and perhaps just slightly more relevant for those who have not. But, again, this is more related to the need to confirm that the national approach is consistent with EU legislation and established practices, than to concrete problems or cases difficult to handle.

Aromatised wine products is the most relevant category in this analysis, but it is useful to note that similar issues may apply to beer and to a very limited extent OFB. The case of beer with added alcoholic flavours lies almost entirely outside of Directive 92/83/EEC, since it was the subject of the Commission Regulation 1967/2005, which established that a product with an addition of alcohol via aromatic components resulting in only 0.04% ABV cannot be excluded from position 2203 and classified in heading 2208.<sup>384</sup> The Regulation on one side establishes the principle that a small addition of alcohol for aroma purposes does not imply a change of CN code, on the other hand relates to a specific product where the addition of alcohol was negligible and classified as beer according to CN 2203. Conversely, the status of mixed beers that come under CN 2206<sup>385</sup> and with an AFC exceeding 0.04% vol cannot be straightforwardly inferred from this Regulation. As for aromatised wine products, various MS reported the adoption of specific thresholds for the addition of AFC to flavoured beer, which are generally lower than for wine (typically 0.5% vol), but much higher than 0.04%. Since these are, again, national-level approaches, there remains a substantial uncertainty with the treatment of these products under the Directive. Unlike wine and OFB, the Directive is silent with respect to the 'entire fermented origin' of beer, so this issue does not fall in the scope of this option. However, if the Directive is amended to clarify the status of products containing AFC, it would be useful, for legal clarity, to cover also the relevant beer mixes.

The case of OFB is of limited relevance since products with an ABV lower than 10% may explicitly contain distilled alcohol, so the addition of AFC would not make any difference. Above this threshold the matter may have some relevance, but besides pre-mix cocktails, and a few special OFB, there are very few products in this ABV band. The matter may have some MS-level relevance where there are specific regulations for cider, establishing when and how much flavourings may be added. The addition of alcohol *per se* is generally banned in the national definition of 'traditional' cider, so AFC may cause its re-classification among generic OFB. This has fiscal consequences e.g. in France and Romania.

With respect to the concrete mechanism to harmonise the treatment of AFC in the Directive, there are three possible approaches:

- a) Establishing a maximum amount of AFC, e.g. 1.2% for flavoured wines and OFB and 0.5% for beer – in line with some MS practices.
- b) Not establishing a maximum amount, but introducing a reference to the strictly necessary dose, in line with Regulation 251/2014.
- c) Combining the two approaches above, establishing that the addition of AFC should be limited to the strictly necessary dose and cannot exceed in any case certain thresholds.

From a legal certainty profile, the first mechanism seem preferable, since it introduces an objective limit that is valid for all but it has two limitations: (i) it is challenging to ascertain the exact content of AFC through analytical methods (customs laboratory tests); (ii) it may encourage a use of AFC greater than the dose strictly needed. The second approach would be more in line with the principle that the tax break regards only

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<sup>384</sup> Regulation 1967/2005, Annex, point 1, page 8.

<sup>385</sup> These products are nonetheless taxed as Beer under Article 2 and not as OFB.

a 'functional' addition of alcohol (in the strictly necessary dose), but it would be more difficult to guarantee a coherent interpretation across EU28, so legal certainty would be hampered. The third approach seems more promising since it combines the principle of the pure functional addition (discouraging the abusive addition of AFC for fortification purposes), and the advantages of making reference to an objective, common threshold.

➤ **MARKET EFFECTS**

The dimension of the market of AFC-containing products is difficult to estimate, and we could only develop hypothetical scenarios in this regard (see Table 18 above). Based on fieldwork evidence, only a minority of MS do not formally accept products with a minimal addition of AFC as 'entirely fermented beverage' and taxed them as if they were fortified products. However, since detecting the addition of small amounts of AFC is analytically very complex, the evidence collected during fieldwork suggests that also in those countries a certain degree of tolerance exists.

It seems very unlikely that the same AFC-containing beverage could be taxed as e.g. wine or beer in one MS and as an IP or ethyl alcohol in another MS. The tax differential would be so significant (with few exceptions) that more probably under such circumstances the product would not be commercialised. Therefore, formalising the existence of a margin of tolerance for AFC-containing beverage would have limited impact in terms of re-classification of existing products. On the other hand, this option would ensure a greater certainty in the treatment of certain products, with eventually beneficial commercial impact.

Quantitative estimates in this area must be taken as purely indicative, however, it can be noted that flavoured products have register some of the highest growth rate in countries with an explicit 'tolerance' threshold, e.g. flavoured beer in the Netherlands (CAGR 2010-16 of +18.2%) and aromatised wine products (non-IP) in Italy (CAGR 2010-16 of + 5.1%). It is possible that a favourable legal and administrative environment, among other things, has contributed to accelerating growth.

In any case, the volume of market at stake is small, possibly comprised between 12 and 30 mn litres for aromatised wine products and 23 to 70 mn litres for flavoured beer.<sup>386</sup> So, also a major contribution to growth of 3 to 5 percentage points would result in a volume increase of 2.0 – 3.5 mn litres, i.e. some 0.3% of the overall total sales of these products.

➤ **TAX REVENUES**

The direct impact on tax revenues from this policy option appears very modest. First of all, it is unlikely that any of the existing products would change of tax category following the adoption of the policy option, since all relevant products are already taxed under the most favourable category. Secondly, the limited effects described above on market developments would translate in marginal variations of the tax base.

Of relevance for tax revenue purposes is only the fact that the AFC contained in the concerned products is possibly not subject to the ethyl alcohol excise duty. Establishing a maximum threshold of 1.2% vol of AFC for aromatised wine products entails that up to between 0.9 to 2.7 mn litres of pure alcohol would therefore pay a lower rate excise duty (wine), with a virtual loss between EUR 16.4 mn and EUR 49.2 mn.<sup>387</sup> A threshold of 0.5% vol of AFC for flavoured beer would instead translate into 0.7 – 2.0 mn litres of

<sup>386</sup> See the estimates laid down in the baseline assessment (Section 2.1.4). The scenario assumes benefits would regard only national markets that currently do not have a formalised tolerance mechanism for AFC (i.e. an estimated one-sixth of the EU market).

<sup>387</sup> Calculated on the basis of the average EU28 excise duty on ethyl alcohol of EUR 1,823.19/hlpa.

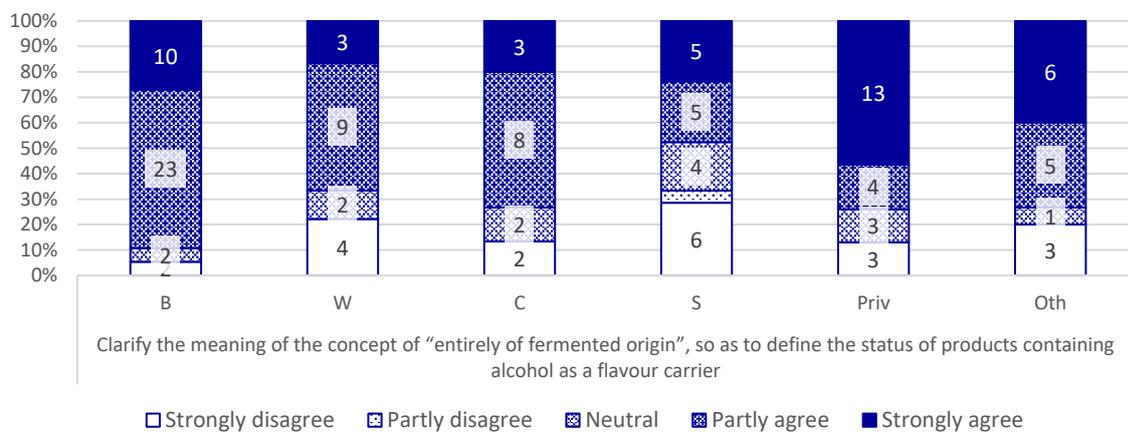
pure alcohol taxed as beer instead of ethyl alcohol, with an excise duty difference of EUR 12.2 – 36.7 mn.

➤ **THE PUBLIC VIEW ON THE PROPOSED POLICY OPTIONS**

**Box 24 – Results from the OPC: stakeholder views on a possible clarification of the terms ‘entirely fermented origin’**

While stakeholders involved in the production of beer, wine and cider are in favour – if not strongly in favour – of a clarification of the concept of ‘entirely of fermented origin’ in connection with products containing alcohol as a flavour carrier, those involved in the production of spirits expressed a somewhat more cautious opinion, with only a relative majority in favour of such option. Over 70% of private individuals and the residual ‘other’ group of respondents also agree with the policy option.

**Question #19** - Please express your opinion on the following possible approaches to address the problems of the definition and classification of alcoholic beverages at the EU level.



**Source:** OPC.

**Legend:** B: industry stakeholders with an interest in the beer sector; W: industry stakeholders with an interest in the wine sector; C: industry stakeholders with an interest in the cider sector; S: industry stakeholders with an interest in the spirits sector; Priv: private individuals; Oth: Other (public health NGOs, public authorities, industry stakeholders with an interest in the production or end-use of industrial alcohol, etc.).

**Note:** producers and associations of fortified wines have been included in the wine industry group. 'Don't know' answers are not displayed.

**3.1.4 Establish a separate Excise Product Code for OFB**

**3.1.4.1 Definition of policy options**

The policy option proposed to address the lack of a specific Excise Product Code (EPC) for OFB is straightforward and consists in revising the scope of codes W200 and W300, which currently merge wine and OFB (respectively still and sparkling), by introducing separate codes for OFB (Option V). The two new codes should capture products falling respectively under Article 12(1) (still OFB) and Article 12(2) (sparkling OFB).

Rather than a change of Directive 92/83/EEC this amendment would concern Annex II, Table 11 (Excise Product) of Commission Regulation 684/2009<sup>388</sup>, as well as of the EMCS and related systems, including at the level of MS authorities and economic operators. The major benefit that can be expected consists in an improved monitoring of the

<sup>388</sup> 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 goods under suspension of excise duty.

market and reduced risk of misclassifications and ensuing tax losses - of which there is limited evidence, however, since in most MS wine and OFB have the same tax treatment. The main costs envisaged relate to the legal and technical update of the current system.

In the case Option (I) above is adopted, and the current OFB category is split into two separate tax categories, further EPC should be evidently introduced. We have assumed that the new category so created would be taxed differently, so the need for a separate code in the EMCS system would be enhanced. The implementation costs would not differ from the Option V analysed here.

**Table 59 - Overview of impact areas of the proposed policy option on differentiating EPC**

Policy Option (not requiring a revision of Directive 92/83)	Impact Areas	Nature of Impact Expected
<b>Introducing a distinct EPC for OFB (revision of Commission Regulation 684/2009 and related technical documents)</b>	• Administrative burden	• To legally and technically update the excise systems at EU and MS level.
	• Tax enforcement and revenues	• Reduced risk of misclassification and of tax losses. • Improved market monitoring.

### 3.1.4.2 Impact analysis

#### ➤ ADMINISTRATIVE BURDEN

The introduction of a separate excise product code for OFB does not require an amendment of the Directive but of the Annexes of Commission Regulation 684/2009 and of the technical and administrative rules of procedure implementing the EMCS.<sup>389</sup> This would have inevitable cost implications for both national authorities and economic operators. The costs incurred by economic operators primarily concern the need to update the enterprise's administrative system to manage the movement of products in compliance with the EMCS and its administrative requirements. The change envisaged is minimal, however all IT systems, templates, manuals etc. should be updated to include the new EPC. As a benchmark, we may consider that setting up and implementing an EMCS-compatible enterprise system 'from scratch' has an estimated cost of EUR 3,000 for a micro/small company, EUR 6,000 for a medium one and EUR 60,000 for a big company.<sup>390</sup> The exact costs of a revision of the system is difficult to calculate but it seems reasonable to assume it would not exceed 20% of the set-up costs. There are very few large producers of alcoholic beverages in all segments as compared to small and micro operators, so we may approximate total costs making reference to only two size groups: small/micro enterprises and medium ones (see Table 60). The estimates have been rounded upwards, to possibly include also a few wholesalers and distributors who operate in suspension of duty and might therefore be concerned. Although the unit cost of the update would be likely limited (possibly EUR 600 – 1200), the sheer number of undertakings affected makes the total administrative burden for economic operators amount to nearly EUR 127 mn. This figure has to be taken prudently, since the number of economic operators actually affected and the costs estimates are uncertain.

Since the revision concerns only OFB, it is possible that only the economic operators active in this segment are required to change their systems and not the others. The technical feasibility of this solution has to be ascertained, but it is worth noting that such

<sup>389</sup> In particular, Appendix B of the FESS (Functional Excise System Specification).

<sup>390</sup> Ramboll Management Consulting, 'Evaluation of current arrangements for the holding and moving of excise goods under excise duty suspension', DG TAXUD, 2015.

solution would radically reduce the overall impact of the proposed revision: if applied to cider-makers only, the total administrative burden would be approximately 1 million EUR. This scenario is somewhat conservative since some producers of wine, beer, and spirits also produce mixed drinks and other OFB beverages. However, also adding these players the overall scale of impact would remain limited.

The administrative burden for public administrations involved are more difficult to estimate. The range of activities to perform is possibly greater and more heterogeneous, involving the amendment of regulation and standard operating procedures, informing and training operators at all levels, and obviously the direct costs of updating the IT systems. The unit cost per country would vary in accordance with the specificities of the administrative system in place and the size of the country, but interviewees were not able to provide a quantitative estimate. Actually, these are considered routine activities that are carried out regularly and do not have a separate budget (the IT system is constantly checked and updated, staff is regularly trained etc.).

Regardless of the limitations in quantifying administrative burden, it can be certainly affirmed that the balance of costs and benefits of this option would likely fall on the negative side. In most EU countries the administrative distinction between wine and OFB is of no practical relevance since the same tax treatment is applied, so for the administrations and the operators from these countries the proposed revision would only bring additional cost and no benefits.

Needless to say, in the event of further changes of the excise duty structure, such as the establishment of new tax categories to differentiate among OFB (Option II), the revision of EPC would become necessary for a proper management and monitoring of products movements, so the intervention would become justified also in costs/benefit terms.

**Table 60 – Estimated administrative burden for SME from a revision of EPC**

Size	Wine-makers	Cider-makers	Breweries	Distilleries	Total	Unit cost (€)	Total costs (€)	Total costs, only OFB (€)
Medium	20,000	300	2000	12,000	34,300	€1,200	€41.2 mn	€0.4 mn
Small/micro	130,000	1000	5500	6,000	142,500	€600	€85.5 mn	€0.6 mn
<b>Total</b>							<b>€126.7 mn</b>	<b>€1.0 mn</b>

**Sources:** Estimates on the number of undertakings have been calculating by extrapolating at EU level the figures collected in six sample countries (AT, BE, FR, IT, PL, UK) through trade associations, tax authorities and ministries of agriculture databases based on mixed sources.

The unit cost per enterprise is estimated assuming that the revision of the enterprise's administrative system (including IT) would cost a fraction (some 20%) of the overall cost of setting up and implementing an EMCS-compatible system at enterprise level (including IT equipment, expertise etc.). The benchmark estimates come from the Ramboll evaluation of Directive 118/2008.

**Notes:** The definition of micro/small varies across the industry sectors and depends on the amount of output. The distribution across industry sectors is mostly based on stakeholders' qualitative estimates and has to be taken with caution. It is possible that a certain amount of undertakings are outside of the excise system and therefore not subject to additional costs.

The estimated total costs do not take into consideration the amortisation period: the estimated total costs may be spread over a 3-5 years period.

## ➤ TAX ENFORCEMENT AND REVENUES

The main expected benefit of implementing this option regards tax enforcement and control. In the current situation, wine and OFB products have the same EPC. The different CN code allows to distinguish between them, but there are cases, especially with aromatised wine products (AWP), falling under heading 2205 or 2206, where it is not explicit if the W200 (or W300) code assigned calls for tax treatment under Article 8 (wine) or Article 12 (OFB). In the vast majority of countries this does not make any material difference since the excise duty rate is the same, but where the applicable rate

is different (FR, HU, IE, MT, PL and RO)<sup>391</sup> the issue is not trivial, and 'mistreatments' are in principle possible.<sup>392</sup>

The analysis of impact can therefore be limited to MS where excise duty on wine and OFB are different. The total volume of OFB in these countries is below 100 mn litres, with Ireland accounting alone for nearly 70%. AWP (not including vermouth) possibly amount to some 55 mn litres. In terms of excise duty revenue, this amount correspond to an overall EUR 322 mn. With the possible exception of MT and RO, the difference in the excise duty is modest: in the six countries identified it amounts to approximately EUR 0.75 per litre (from EUR 0.05 in FR to EUR 1.85 in MT). There are no estimates on the frequency of 'mistreatments' and the evidence from fieldwork suggests they are quite rare in practice. For purely illustrative purposes, assuming that 1% of the products traded in these countries is erroneously classified, due to the indefinite EPC, and that the error is always in the sense that the lower excise duty rate is paid, the aggregated excise duty loss would be of EUR 1.1 mn.

The adoption of a separate EPC for OFB may redress this problem and ensure a more accurate enforcement, reducing the risk of errors and the ensuing foregone revenue. The scale of the problem is however so small that it may not justify *per se* the adoption of this measure. Moreover, it is not evenly distributed across MS: for countries, like MT and RO, where the tax rate differential between wine and OFB is high, the reduction of classification errors may have tangible effects on the budget; for other countries it would likely be negligible.

Finally, it is important to highlight that beyond tax revenues effects, the introduction of a separate EPC for OFB would bring significant added value in terms of monitoring and control of the market and excise duty trends (also in line with the proposed Option III.d). At present tax authorities are seldom able to differentiate, and therefore to appreciate the market trends of OFB, which is the category that mostly contains new and 'borderline' products, so they have access to limited data evidence to support their tax policy decisions.

➤ **THE PUBLIC VIEW ON THE PROPOSED POLICY OPTIONS (OPC)**

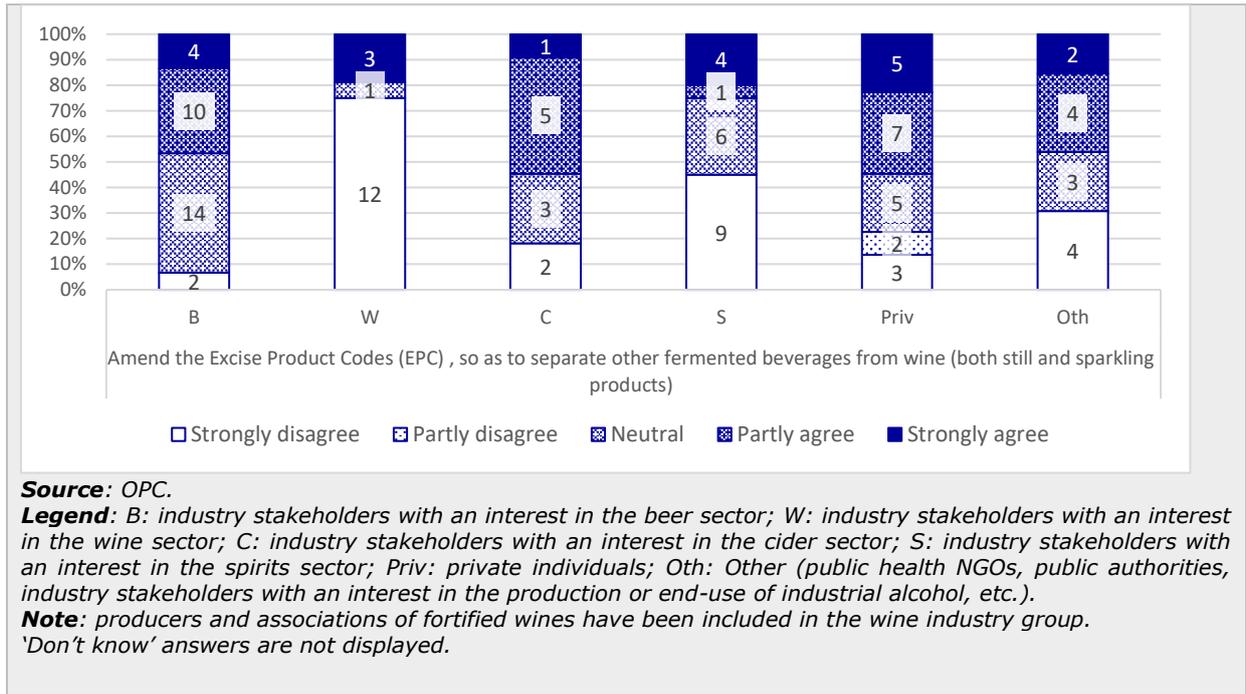
**Box 25 – Results from the OPC: stakeholder views on a possible differentiation of EPC**

As in various other instances, this option was characterised by a polarisation of industry respondents, with wine and spirits producers mainly against it (notably, over 70% of stakeholders involved in the production of wine were strongly against the policy option) while beer and cider producers mainly in favour.

**Question #19** - Please express your opinion on the following possible approaches to address the problems of the definition and classification of alcoholic beverages at the EU level.

<sup>391</sup> In HU and RO the excise duty rate on OFB is greater than wine, in all other countries it is the opposite.

<sup>392</sup> In certain countries (e.g. IT) there exists national tax codes that distinguish between wine and OFB.



## 3.2 Exemptions for denatured alcohol

As discussed in Section 2.2, problems in the area of denatured alcohol stem from the following issues:

- Completely denatured alcohol (CDA):
  - Incomplete / inconsistent mutual recognition of CDA
- So-called 'partially' denatured alcohol (PDA):
  - Proliferation of national approaches to PDA
  - Divergent interpretation of the terms of Article 27(1)(b)
- Relevant to both CDA and PDA:
  - Risk of fiscal fraud and related health concerns

This Section outlines a series of policy options to tackle these issues (in the order in which they are listed above – though note that fraud risks are covered as part of the options related to both CDA and PDA, rather than a separate set of options), and discusses their likely impacts, in comparison with the dynamic baseline (i.e. no policy change) and based on the available evidence.

### 3.2.1 Full harmonisation of CDA formulations

With the adoption of Regulation 2017/1112 and the entry into force of the new list of CDA procedures on 1 August 2017, the EU has taken a very significant step towards the harmonisation of formulations for completely denatured alcohol (CDA). As things currently stand, 25 MS<sup>393</sup> are expected to recognise the 1-1-1 Eurodenaturant, and only 3 MS (CZ, SE, UK) recognise different concentrations of the same ingredients. In addition, from 2019 (when the authorisation of the remaining FI formulation expires), only 2 MS (CZ, EL) will still be using national formulations containing different denaturants. As described in Section 2.2, this greatly reduces (but does not completely eliminate) the scope for problems arising from the manifestly unclear rules on recognition of CDA formulations stipulated in Article 27(1)(a) of the Directive.

An obvious policy option would therefore be to seek full harmonisation across all MS. This could entail:

- Agreement on a single formulation, containing the same denaturants in the same concentration, for CDA across the entire EU.
- Elimination of all remaining national formulations.
- Potentially a significant change in the wording of Article 27(1)(a), as well as 3 and 4, to reflect a new procedure for defining the common formulation, which would supersede the current process of notification by the MS.

None of these aspects would be likely to be straightforward in practice, for the following reasons. The obvious candidate for a common formulation is the 1-1-1 Eurodenaturant consisting of 1L of IPA, 1L of MEK, and 1g of denatonium benzoate per hl of absolute ethanol. However, it does not appear as if the MS that have so far insisted on higher concentrations were ready to accept this, due to concerns over the robustness of the lower concentrations of MEK and, to a lesser extent, IPA. Similarly, the MS that continue to use national formulations insist these are robust formulations within the spirit of the Directive, and are important to specific national industry sectors. They therefore see no reason to withdraw them.

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<sup>393</sup> This includes BG and RO, who have recently notified their intention to switch from 3-3-1 to 1-1-1, and HR, which has notified a concentration of 'at least' 1-1-1.

If agreement on a single common formulation could be reached, then it would appear sensible (although not strictly necessary) to also consider changes to the procedure whereby, currently, CDA formulations need to be notified by MS and approved (in accordance with Articles 27(3) and 27(4)). This meant that, prior to the adoption of Regulation 2017/1112, each MS intending to use the Eurodenaturant had to individually notify the Commission of this. In future, if a single formulation was in use across all MS, it might be preferable to write this directly into Article 27 of the Directive, and develop a new, ideally more agile mechanism for potential future changes. This could entail, for example, a procedure by which MS could raise concerns and/or propose alternative formulations via the Excise Committee.

Most stakeholders who were interviewed for this study, as well as a slight majority of respondents to the open public consultation, were in favour of the full harmonisation of CDA formulations. However, as noted, there is strong opposition from a limited number of MS. Furthermore, even those MS that are in favour of the 1-1-1 Eurodenaturant may wish to retain control over possible future changes, i.e. to still be able to notify alternative formulations if this were to be deemed necessary in future for whatever reasons.

Therefore, this option is very unlikely to be feasible at the present point in time due to resistance from some MS. Full harmonisation was the explicit objective of the process begun in 2008, and has turned out to not be achievable so far. This could change if/when the MS that are currently opposed to adopting the 1-1-1 Eurodenaturant and/or eliminating their remaining national CDA formulations, change their position. Until then, it appears futile to further pursue full harmonisation.

### 3.2.2 Clarify mutual recognition of CDA

In the absence of full harmonisation, it may still be worthwhile to clarify the rules for mutual recognition of CDA, and thereby eliminate any remaining room for divergent interpretations. In principle, there are three possible sub-options:

1. **Full mutual recognition:** All MS would have to recognise all procedures notified by all MS, irrespectively of where the alcohol was produced / denatured. This would effectively eliminate all national differences, and mean that a formulation notified by a given MS could be used by producers across the EU, and the resulting alcohol recognised as completely denatured by all MS.
2. **Limited mutual recognition:** Each MS would only be obliged to recognise its own formulation(s), but irrespectively of where the alcohol was produced / denatured. This would mean that a producer in a given MS would have to use different CDA formulations for different national markets.
3. **'Hybrid' mutual recognition:** Each MS would have to recognise CDA produced in another MS using the formulations notified by that particular MS, but not those notified by any other MS. This would mean that MS retain control over the CDA produced within their territories, while being obliged to also exempt any CDA legally produced in another MS.

To illustrate the difference between the three approaches, consider the example of the remaining CZ national formulations: under the first approach, all MS would have to allow their economic operators to use these formulations. Under the second approach, alcohol denatured in CZ using these formulations would not have to be recognised as CDA by any other MS, although producers in other MS would be able to produce and move this to CZ as CDA. Under the third approach, the CZ formulations could only be used in CZ,

but alcohol denatured in CZ using these formulations would have to be treated as CDA and therefore exempted by all MS.

The advantage of approaches 1 and 2 is that they would eliminate any discrimination on the grounds of where an economic operator is based. The rules would essentially be the same for all (across the EU in the case of approach 1, or in all national markets in approach 2). However, approach 1 would require MS to fully accept all formulations, thereby effectively turning the remaining national formulations into additional Eurodenaturants, which most would not find acceptable. Approach 2 would be preferable to those MS that insist on 3-3-1 or another variant of the Eurodenaturant, as it would shield their national markets from cheaper 1-1-1 CDA from other MS. However, it would be more restrictive than the current situation, and be challenging to monitor and enforce, as CDA produced legally in any MS is released for consumption, and would therefore be difficult to effectively keep from crossing intra-EU borders.

The most realistic option is therefore approach 3, which is also most closely aligned with the current interpretation of Article 27(1)(a) by the Commission and most MS. While the requirements (including the formulations) for complete denaturation continue to differ between MS, CDA produced anywhere is exempted throughout the EU as long as it meets the requirements of the MS where it was denatured. To clarify this, the text of Article 27(1)(a) would need to be amended from *'alcohol which has been completely denatured in accordance with the requirements of any Member State'* to *'alcohol which has been completely denatured in any Member State in accordance with its requirements'* (or a different wording to the same effect).

A potential issue with this wording is that it leaves open the question of how imports of CDA from third countries are treated. At present, most MS seem to take the view that these are exempt if denatured in accordance with the requirements of any MS (which gives third country producers a wider range of formulations to choose from than producers based in an EU MS). Although the amount of CDA imported from third countries is very small at present, this could potentially change in future, so legal certainty is important. It should therefore be considered whether the insertion of a clause to clarify this (e.g. *'alcohol which has been completely denatured in, or imported from a third country to, any Member State in accordance with its requirements'*) and/or the issuance of guidance, would be necessary.

The main impact areas of this options are summarised in Table 61, and discussed in more detail below. Since most problems with mutual recognition have already been eliminated with the adoption of the 1-1-1 Eurodenaturant as their only remaining national formulation by the majority of MS, and the option would essentially codify the approach to mutual recognition already taken by most MS, the actual economic impacts would be limited. However, it would enhance clarity and legal certainty, and thereby contribute to avoiding the occurrence of possible problems in future.

**Table 61 – Overview of impact areas of the proposed policy option on mutual recognition of CDA**

Regulatory Option (Revision of Directive 92/83/EEC)	Impact areas	Nature of Impact Expected
<b>Clarify mutual recognition of CDA</b>	<ul style="list-style-type: none"> <li>Legal certainty for authorities and businesses</li> </ul>	<ul style="list-style-type: none"> <li>Avoidance of divergent interpretations by MS, disputes and associated costs</li> </ul>
	<ul style="list-style-type: none"> <li>Single Market functioning</li> </ul>	<ul style="list-style-type: none"> <li>Reduction of the remaining trade barriers and distortions due to restrictive interpretation of mutual recognition by some MS</li> </ul>
	<ul style="list-style-type: none"> <li>Operating costs for businesses</li> </ul>	<ul style="list-style-type: none"> <li>No impact on most businesses, as this would only codify the approach already taken by most MS</li> <li>Positive impacts for producers and users that move CDA to / from MS with different national formulations</li> </ul>

Regulatory Option (Revision of Directive 92/83/EEC)	Impact areas	Nature of Impact Expected
		<ul style="list-style-type: none"> <li>Negative impacts for producers of CDA in certain MS who may face increased levels of foreign competition</li> </ul>

➤ **LEGAL CERTAINTY AND FUNCTIONING OF THE SINGLE MARKET**

As discussed previously, there have in the past been disputes between MS and economic operators over whether or not certain business practices qualify for the exemption as CDA, in particular the use of formulations notified by a MS other than the one where the denaturing process took place. To the best of our knowledge, all such cases have by now been resolved, and the widespread adoption of the Eurodenaturant greatly reduces the scope for disputes in future. Nonetheless, the current wording of the Directive could – in theory at least – still lead economic operators to claim they are entitled to use any of the formulations notified by any MS. For example, CDA producers in MS that require a higher concentration of the Eurodenaturant ingredients could attempt to force their authorities to allow them to use 1-1-1 instead to fend off competition from producers in other MS; while the authorities of those MS could attempt to restrict the free movement of 1-1-1 CDA in their respective MS to protect their national producers. Although there are no indications of any plans for this at present, a clarification of the rules of Article 27(1)(a) could categorically rule out any such attempts, and thereby enhance legal certainty for CDA producers and users, avoid any costs related to legal disputes, and strengthen the Single Market from any possible protectionist tendencies by certain MS.

➤ **OPERATING COSTS FOR BUSINESSES**

Following on from the above, certain businesses in specific circumstances would benefit from the enhanced clarity and certainty. The extent of this would vary greatly depending on their specific situation, and is therefore not possible to estimate comprehensively. The main groups of businesses that would be likely to benefit are:

- Producers of CDA located in a MS that has adopted the 1-1-1 Eurodenaturant, and who wish to supply customers in different MS, as the likelihood of non-recognition and the risks inherent in this would be further reduced. This could provide new opportunities to engage in intra-EU trade and benefit from cost savings and economies of scale due to the smaller number of formulations in use and associated storage and other costs.
- Users of CDA – in particular those that are located in a MS that has not adopted the 1-1-1 Eurodenaturant – who might be able to source CDA more cheaply from a supplier in a MS other than their own, and benefit from the reduced likelihood of non-recognition.

On the other hand, producers of CDA in 'non 1-1-1' MS are likely to see increased competition from abroad, as customers increasingly demand 1-1-1 CDA and switch to foreign suppliers.

With all this, it is important to reiterate that by far the more significant impacts stem from the entry into force of Regulation 2017/1112. Clarifying the mutual recognition requirements is likely to contribute to securing and consolidating the cost savings that are likely to accrue to certain economic operators, and avoiding future disputes and complications. But the change to the wording of the Directive would be a minor factor, as it would not lead to any significant immediate changes in the interpretation of the rules.

### 3.2.3 Full harmonisation of PDA formulations

As discussed in detail in Section 2.2, the non-harmonised regime for so-called 'partially' denatured alcohol (PDA) has fostered the existence of 28 national regulatory frameworks, each of which recognises different PDA formulations. This results in varying (and in some cases, very substantial) compliance costs for economic operators. In certain circumstances, when cross-border movements of PDA or products containing PDA are involved, it can also lead to legal uncertainty, barriers to trade, or an increased risk of fraud. At the same time, as noted in Section 2.2, this is most often due to the choices of MS authorities in implementing the Directive and supervising the production, movement and use of denatured alcohol, rather than issues with the text of the Directive itself.

One way of reducing the existing disparities and thereby the barriers to cross-border trade would be to harmonise the PDA formulations that are authorised in the MS. Since it is universally recognised that different end uses call for different formulations, harmonisation would not mean a single formulation (as in the case of the Eurodenaturant for CDA), but a list containing several formulations, each of which might be applicable for one or more uses (such as the manufacture of cosmetic products; screen wash; printing ink; road fuel; etc.). Many MS already have such lists, and in theory at least, it should be possible to devise a common list containing a limited number of formulations. The system in use in the US is often mentioned as a reference point; in addition to 5 formulations for completely denatured alcohol, the relevant regulation lists 32 formulations for 'specially' denatured alcohol. Each formulation is assigned a number, and is authorised for one or more specific uses, of which there are over a hundred, each of which is also assigned a number.<sup>394</sup>

Exploratory work on a harmonised list of PDA formulations has already been carried out within the Fiscalis Project Group for certain sectors, namely (1) perfumes, cosmetics and (personal) hygiene products, and (2) screen wash, de-icer and anti-freeze. Reportedly, the discussions regarding the former turned out to be particularly difficult, mainly because the national approaches are currently so different, with some MS authorising denaturation with ingredients of the final product (such as essential oils) in specific cases, while others have a strictly defined list (or a single formulation) that applies to all producers equally. Unless either group of MS is prepared to substantially alter its approach, agreement among all MS on a harmonised list covering all sectors therefore seems out of reach. Respondents to the OPC were split almost exactly evenly between those in favour and those against developing a common list of PDA formulations authorised across all MS, with representatives of the cosmetics and fragrance industry especially strongly opposed (since the sector currently benefits from the flexible regulatory approach in certain MS, including the option of using 'in situ' denaturation), and warning of significant cost implications of a change to the current flexible approach. In view of these challenges, we conclude this option is not feasible at the current point in time.

### 3.2.4 Partial harmonisation of PDA formulations

In view of the difficulties with full harmonisation, an alternative approach to the harmonisation of PDA formulations could be one that combines two elements:

- (1) a harmonised list that is applicable across the EU (as discussed under the previous option), and

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<sup>394</sup> See <https://www.ttb.gov/industrial/sda.shtml>.

- (2) the ability for MS to authorise different formulations for specific uses where the fiscal risk is demonstrably low.

Such an approach should make it easier for MS that currently employ a very flexible approach (such as DE, ES, FR) to agree to a relatively short, restrictive list of formulations, as they would still be able to deviate from the list in specific circumstances. Nonetheless, agreement is by no means guaranteed, as the extent to which MS would have to make changes to their current approaches to PDA under such a 'partially harmonised' regime would depend on a number of factors, among them the process for developing and amending the harmonised list, and the criteria to determine what constitutes a 'low' fiscal risk.

Indicatively, the following broad approach to implementing this policy option could be taken:

- The existing FPG or another appropriate expert group would have to first define a list of uses, which might include around 5-10 specific industry sectors / types of products, as well as a category for road and heating fuels, and potentially one for 'general' industrial use not falling under any of the other categories. It would then have to review formulations that are currently authorised in the different MS, with a view to developing a harmonised list containing a limited number of formulations per sector.
- The conditions under which MS are allowed to authorise the use of formulations other than those on the harmonised list would need to be defined by an appropriate body. They should emphasise the concept of the fiscal risk arising from the products for which the PDA is used. Applying these criteria, the competent authorities of the MS in question could authorise specific non-harmonised denaturants on a case-by-case basis if they deem it highly unlikely that the product could be used fraudulently (e.g. because its composition and/or retail price makes this non-viable).
- It would also have to be clarified how this new approach could be enshrined in the text of the Directive, and what the procedures for amending the harmonised list would be. This includes consideration of whether a mechanism should be introduced to allow MS to challenge the specific 'low fiscal risk' authorisations granted by another MS to its economic operators.

It follows that, if this option is pursued, further preparatory work may be required before legislative changes to the text of the Directive are made. MS would be far more likely to agree to such potentially far-reaching changes if they had a reasonably clear idea of the exact implications.

**Table 62 – Overview of impact areas of the proposed policy option on developing a harmonised list of PDA formulations**

Regulatory Option (Revision of Directive 92/83/EEC)	Impact areas	Nature of Impact Expected
<b>Develop a harmonised list of PDA formulations, while allowing MS to authorise other formulations in cases where the fiscal risk is demonstrably low</b>	• Legal certainty	• Transparency and certainty increased, but not fully guaranteed
	• Operating costs for businesses	• Harmonisation would be beneficial for PDA producers and users that operate in more than one MS • Possible negative effects for users whose current PDA formulations are not on the harmonised list
	• Single Market functioning	• Reduced barriers to intra-EU trade, fairer competition between PDA producers and users in different MS
	• Enforcement costs for national authorities	• Time investment in developing harmonised list • Tests by customs laboratories less difficult – though a harmonised list could also make it more difficult to determine the origin of samples

Regulatory Option (Revision of Directive 92/83/EEC)	Impact areas	Nature of Impact Expected
	<ul style="list-style-type: none"> <li>Fiscal fraud risk</li> </ul>	<ul style="list-style-type: none"> <li>Reduced risk of fraud involving products containing 'weakly' denatured alcohol (uncertain)</li> <li>Risk could increase if MS apply the concept of 'low fiscal risk' too loosely</li> </ul>

The impacts of this option (as summarised in Table 62) are difficult to anticipate with certainty, as they would depend to a large extent on how exactly the option is implemented (including how extensive the harmonised list is), and how the competent authorities of MS would react to the new rules. Very broadly speaking, if MS use the opportunity to review their national approaches and genuinely aim to minimise the number of specific formulations authorised for individual firms to those cases where the use of one of the formulations on the harmonised list is not suitable, and the fiscal risk is minimal, the impacts could be significant. If, on the other hand, it would essentially mean a continuation of the status quo, and certain MS continue to rely primarily on individual authorisations, the benefits would be more limited.

#### ➤ **LEGAL CERTAINTY AND FUNCTIONING OF THE SINGLE MARKET**

A harmonised list of PDA formulations would ensure a level playing field for economic operators across the MS, and the resulting transparency in this respect would make cross-border trade in PDA easier by removing the element of uncertainty. This could potentially result in cost savings for a range of economic operators as well as competent authorities (see below). At the same time, it needs to be reiterated that the different PDA formulations that are currently authorised are not the only barrier to trade or source of potential competitive distortions – in the view of most stakeholders, the administrative requirements stemming from the supervisory regimes are at least as, if not more, significant, and this option would do nothing to harmonise these.

Furthermore, the possibility for MS to authorise exceptions (i.e. different formulations that are not on the harmonised list) for individual operators would limit the transparency and legal certainty, and consequently the benefits for the functioning of the Single Market from this option. If this possibility is widely used (by those MS that currently allow individual authorisations, and perhaps even by those that do not), the gains could be minimal, as the publicly available harmonised list would not be an accurate reflection of what formulations are authorised in practice.

#### ➤ **OPERATING COSTS FOR BUSINESSES**

Certain producers and users of PDA could benefit from the enhanced transparency and legal certainty on the one hand, but also from the potential access to new PDA formulations on the other hand. This includes in particular:

- PDA users from a potentially wide range of sectors that gain access to a greater variety of PDA formulations (because the harmonised list for their sector is more 'liberal' than that currently in use in their MS). The extent of this *potential* impact, and who exactly would benefit, is impossible to anticipate without a detailed comparative analysis of the current national and future harmonised lists of formulations.
- PDA users that operate in more than one MS, and will be able to use the same formulations in all of them, resulting in cost savings. This is likely to be the case of a few dozen medium-large businesses across the EU; the extent of the potential savings per business could vary hugely.
- PDA producers for whom the enhanced transparency and legal certainty should make it less risky and costly to supply potential customers in other MS.

- PDA users who could benefit from slightly reduced PDA prices due to the increased international competition. However, it should be noted that, given existing price differences between EU MS tend to be small, and transport costs are an important factor, the gains are likely to be marginal.

On the other hand, PDA users in certain MS and sectors may be negatively affected if the harmonised list is different from that which is currently in use in the MS in which they are based. Switching PDA formulations can incur significant transition costs, both from adapting production processes and supply chains, and from obtaining authorisations for these. Of particular concern would be cosmetics and fragrance manufacturers in MS with a flexible regime (such as DE, ES and FR) who currently use PDA formulations authorised for them specifically. In principle, such authorisations could be continued under the new regime where the fiscal risk is low, but how exactly this would work in practice, and whether it would cover all operators that currently work with individually approved formulations, would remain to be seen.

#### ➤ **ENFORCEMENT COSTS FOR NATIONAL AUTHORITIES**

As discussed in chapter 3.2, the customs laboratories in certain MS (those where fraud with illicit including surrogate alcohol is a significant problem) reportedly suffer from a heavy workload due to the currently very large number of PDA formulations in use across the EU, which means testing suspicious samples of unknown origin is often very time and resource intensive. A harmonised list of denaturants would significantly reduce this burden (currently estimated to amount to around EUR 300,000 to EUR 500,000 per year across all MS), and enable laboratories to more systematically plan their approach and resources for testing.

Finally, the development and agreement of a harmonised list of PDA formulations, and of criteria for what constitutes 'low fiscal risk', would require a potentially significant investment of (primarily human) resources by the MS and the Commission. To provide a benchmark, between 2009 and 2016, the Fiscalis Project Group on the Eurodenaturant (phases 1 and 2) met a total of 25 days (including one 3-day seminar), with an average of 25 MS and 3 Commission participants, which equates to a total of at least 700 days of staff time. Time invested outside of the formal meetings (including for laboratory tests), as well as travel and other expenditure, would need to be added. In view of this, the effort that is likely to be required to come up with a harmonised list for PDA should not be underestimated. At the same time, it is worth noting that a significant amount of exploratory and preparatory work has already been done within the FPG, including scoping of options for harmonised PDA formulations for two sectors (cosmetics and screen wash / anti-freeze). Any future work could build on this.

#### ➤ **FISCAL FRAUD RISKS**

As outlined previously, the use of alcohol recovered from certain products that contain PDA for the production of illicit alcoholic beverages – or the consumption of such products 'as is' – is one of the main sources of fiscal fraud. While in the past this was reportedly less common than fraud involving CDA, its importance may well grow in the future, due to the recent replacement of many 'weaker' CDA formulations with the Eurodenaturant, which should make fraud involving CDA more difficult and/or costly, and is likely to lead fraudsters to consider alternatives. Certain MS are critical of the PDA formulations that are currently authorised in certain MS, which they argue represent a fraud risk, particularly when they involve ingredients that would be present in the finished product anyway, and lack a chemical marker.

A harmonised list with a limited number of well-justified exceptions (i.e. instances where MS authorities authorise different formulations for individual users) would not eliminate such 'weak' formulations, but would restrict their use to cases of demonstrably low fiscal

risk, i.e. when the products in question do not lend themselves to fraudulent uses for price or other reasons. If implemented strictly, this has the potential to limit the use of such formulations to certain sectors and/or users, and provide some guarantees that the inherent risks (ideally for the EU as a whole, rather than only for the MS in question) have been properly assessed. This could have a potentially profound impact in terms of minimising fraud risks, and reducing the amount of excise duty revenue lost, primarily by EU-13 MS (estimated at somewhere in the region of EUR 170 million per year, although the exact amounts are not known).

However, the competent authorities of those MS that currently authorise non-standard PDA formulations (i.e. formulations that are not contained in a positive list of authorised procedures) for individual users tend to argue that they already apply a risk-based approach when assessing such applications, and only authorise formulations / procedures they deem to be proportionate to any risks. As such, this option would only lead to a reduced risk of fraud if it led MS to modify their approaches to risk assessment in practice, and/or to require stronger evidence that none of the formulations on the harmonised list are suitable before authorising an exception.

### **3.2.5 Database of national PDA formulations**

A 'softer' alternative to the harmonisation of PDA formulations would be a requirement for MS to notify their authorised formulations to the Commission, and for these to be published in a database that is accessible to any interested parties. This would enhance transparency, and allow economic operators to check whether a given formulation they would like to supply or procure is authorised in the relevant MS, thereby enhancing legal certainty and reducing a barrier to trade, which was described as non-trivial by some of the interviewed stakeholders.

A 'European alcohol denaturant database' already exists; it was launched in 2011, is managed by the Commission (JRC), and is accessible to MS national authorities and the Commission only.<sup>395</sup> However, according to the JRC, the database has fallen into disuse in recent years, as MS have failed to update it in a timely manner with details on their national formulations. To achieve its full potential, the information in the database would have to be comprehensive and up-to-date, and would have to be accessible to economic operators. Neither is the case at present. If this option is pursued, ways would need to be found to secure the MS' collaboration in populating and updating the database on a regular (at least annual) basis. This may require a legal requirement to be inserted into the Directive.

Another issue relates to the authorisation by some MS' authorities of specific formulations authorised for individual users only. These can account for a significant share of PDA in MS such as DE, ES and FR, and are usually not in the public domain. As in the case of the previous option (partial harmonisation), their continued existence limits the effectiveness of this option, as the database (and therefore transparency) would never be 100% complete. This could be partly addressed by including a very clear reference in the database to which MS only authorise formulations that are on the published list (although they might amend / expand this list if the need arose), and which MS authorise other formulations for individual users on request (without amending the general list).

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<sup>395</sup> The database includes information on denaturants (including key characteristics such as how easy to remove they are and their toxicity) and on formulations (including approved uses, estimated number of manufacturers and users, etc.).

The impacts of this option are all related to the increased transparency, and would be broadly similar to those discussed under the previous option, albeit on a significantly smaller scale. No impact on reducing the risk of fraud is expected.

**Table 63 – Overview of impact areas of the proposed policy option on developing a database of PDA formulations in each MS**

Non-regulatory Option	Impact areas	Nature of Impact Expected
<b>Develop a database of national PDA formulations in each MS</b>	<ul style="list-style-type: none"> <li>Legal certainty</li> </ul>	<ul style="list-style-type: none"> <li>Transparency and certainty increased, but only as regards those MS that operate a positive list of PDA formulations</li> </ul>
	<ul style="list-style-type: none"> <li>Operating costs for businesses</li> </ul>	<ul style="list-style-type: none"> <li>Cost savings for producers of PDA wishing to supply customers in other MS due to the increased transparency</li> </ul>
	<ul style="list-style-type: none"> <li>Single Market functioning</li> </ul>	<ul style="list-style-type: none"> <li>Reduced barriers to intra-EU trade due to greater transparency</li> </ul>
	<ul style="list-style-type: none"> <li>Enforcement costs for national authorities</li> </ul>	<ul style="list-style-type: none"> <li>Positive impact, as competent authorities could refer to the database</li> <li>Costs for the EU and MS to build, maintain and update the database (higher if in all EU languages)</li> </ul>

Taking these impact areas in turn:

- Legal certainty:** This would be enhanced as a result of the greater transparency, meaning interested economic operators and authorities could obtain accurate information on authorised PDA formulations online. The caveat relates to those MS authorise other formulations for individual users on request, as these would not be reflected in the database.
- Operating costs:** Producers of PDA who wish to supply customers in other MS would save time when it comes to checking the requested formulation is authorised in the receiving MS, and (where necessary) providing proof of this to their own national authorities. However, the cost savings from this would be quite minor (the equivalent of no more than a few hours' time per process).
- Single Market functioning:** The lack of transparency concerning which formulations are authorised in different MS is a minor obstacle to intra-EU trade according to some economic operators; greater transparency would therefore result in slightly improved functioning of the Single Market for PDA.
- Enforcement costs:** In the sense that national authorities could also refer to the database, and have sufficient confidence in its content to use it when reviewing applications, there would be likely to be minor time and cost savings. On the other hand, there would be minor costs associated with building, maintaining and updating the database, some of which would have to be borne by the MS.

### 3.2.6 Confidence / capacity building measures

Finally, some stakeholders believe that many of the difficulties regarding the treatment of PDA arise due to a lack of trust between MS authorities, who use very different approaches to supervising the production of (partially) denatured alcohol, and are sometimes suspicious of the apparent lack of effectiveness of other countries' procedures and formulations. It has therefore been suggested that some of the resulting difficulties could be resolved by more information sharing and, where appropriate, specific measures to enhance the supervisory capacity of MS that may have a need for this. This could involve seminars, study / working visits, twinning or exchange between the relevant departments of MS tax and customs administrations. The EU could provide financial support via the Fiscalis programme (which can also provide support for multilateral controls of taxable persons, where appropriate).

When interviewed, representatives of the national authorities were not fundamentally opposed to the idea, but found it difficult to anticipate what exactly they (or their counterparts) might learn as part of such an initiative, and therefore voiced doubts as to whether it was necessary or would have any significant effects in practice.

What appears most promising would be actions to bring together officials from MS where fraud with surrogate alcohol is a significant problem, and those where it is not, to help them understand the challenges they face, respectively, if and how goods made with PDA in certain MS could be used to commit fraud in another, and how the risk of this occurring could be minimised.

A clear majority (85% of those who expressed a view) of OPC respondents were in favour of this option. However, anticipating the benefits of such measures with any degree of confidence is very difficult, as any impacts would depend on changes in regulations and/or administrative practices MS decide to make based on the information and experience gained as part of the exchanges with other MS.

**Table 64 – Overview of impact areas of the proposed policy option on confidence / capacity building measures for MS**

Non-regulatory Option	Impact areas	Nature of Impact Expected
<b>Fund confidence / capacity building measures for the competent national authorities</b>	<ul style="list-style-type: none"> <li>Enforcement costs for public authorities</li> </ul>	<ul style="list-style-type: none"> <li>EU funding via the Fiscalis programme</li> <li>MS and EC human and financial resources</li> </ul>
	<ul style="list-style-type: none"> <li>Single market functioning</li> </ul>	<ul style="list-style-type: none"> <li>Highly uncertain – may lead to fewer disputes / barriers if MS adopt more consistent rules / practices</li> </ul>
	<ul style="list-style-type: none"> <li>Operating costs for businesses</li> </ul>	<ul style="list-style-type: none"> <li>Highly uncertain – may lead to reduced costs if MS adopt more consistent rules / practices</li> </ul>
	<ul style="list-style-type: none"> <li>Fraud risk</li> </ul>	<ul style="list-style-type: none"> <li>Highly uncertain – may lead to reduced risks if MS adopt stricter rules / practices</li> </ul>

In summary:

- Enforcement costs:** The cost of such measures would obviously depend on their frequency and intensity. In addition to the funding from the Fiscalis programme budget, which covers in particular travel costs (for reference, approx. 22% of the Fiscalis budget – around EUR 35.5 million – was spent on joint actions during the 2007-2013 programming period), MS authorities would have to make available the requisite human and other resources.
- Indirect impacts:** All other impacts – including an improved functioning of the Single Market, reduced operating costs for businesses, and a reduced fraud risk – would be dependent on improvements in the working practices of customs authorities made as a result of the confidence / capacity building measures. There is likely to be potential for such improvements based on weaknesses or inconsistencies identified as part of such measures, but any attempts to predict the extent to which these would be acted on, and the potential benefits from doing so, would be highly speculative.

### **3.2.7 Clarify Article 27(1)(b), in particular the terms ‘used for the manufacture of’**

The term ‘used for the manufacture of’ in Article 27(1)(b) is widely viewed as ambiguous, which has led to questions and divergent interpretations among MS as to whether indirect uses of PDA, such as cleaning or sanitisation of manufacturing equipment, are also exempt. Most but not all MS seem to interpret the term to mean that they are. And even though the Commission has previously expressed the view that, strictly speaking, Article 27(1)(b) only covers the direct use of PDA as an ingredient,

there is nothing to suggest that taking the opposite view would increase the risk of fraudulent use, as long as the alcohol in question is properly monitored, recorded and disposed of following its use. In the OPC, a clear majority of respondents (67% of those who expressed an opinion) disagreed that the term 'used for the manufacture of' should be restricted to the direct use, and not include indirect uses such as cleaning, disinfection or other adjacent activities.

The ambiguity could be eliminated by clarifying the wording of the Article. In doing so, it would appear sensible not to restrict the use of PDA unnecessarily, and follow the approach taken by most MS (and preferred by stakeholders) of allowing 'indirect' uses to also benefit from the exemption. This could entail wording along the lines of '*used as part of the manufacturing process, including for the maintenance and cleaning of the manufacturing equipment*', or a similar formulation that is deemed sufficiently unambiguous from a legal point of view.

If Article 27(1)(b) is to be amended, it would also be worth considering whether its overall clarity can be improved. While a clear majority of OPC respondents agreed that the difference between the two categories currently defined in the Directive (CDA /PDA) is clear as well as useful in practice, the opinions as to whether implications of the two categories regarding the production and movement of denatured alcohol are clear were split almost evenly, with a large number of neutral responses (which may indicate views similar to those expressed by many interviewees, namely that the implications are not necessarily obvious from the text of the Directive itself, but have been largely clarified in its transposition into national law). In other words, while the distinction between CDA and PDA is generally well understood by those who deal with denatured alcohol, the wording of the Directive is not particularly helpful in this respect. It might therefore be useful to amend the text concerning PDA to read more or less as follows:

*'when used as part of the manufacturing process of any product not for human consumption, including for the maintenance and cleaning of the manufacturing equipment, provided the alcohol has been denatured in accordance with the requirements of the Member State in which said production process takes place for such uses. Until the manufacturing process has been completed, the alcohol has to be processed, held, received and dispatched under a duty suspension arrangement in accordance with Directive 2008/118/EC'.*

**Table 65 – Overview of impact areas of the proposed policy option on clarifying the terms 'used for the manufacture of' (Article 27(1)(b))**

Regulatory Option (Revision of Directive 92/83/EEC)	Impact areas	Nature of Impact Expected
<b>Clarify Article 27(1)(b), in particular the terms 'used for the manufacture of'</b>	<ul style="list-style-type: none"> <li>Legal certainty</li> </ul>	<ul style="list-style-type: none"> <li>Enhanced clarity regarding the legal meaning and uses of 'partially' denatured alcohol</li> <li>Elimination of ambiguity and uncertainty regarding indirect uses of PDA</li> </ul>
	<ul style="list-style-type: none"> <li>Single Market functioning</li> </ul>	<ul style="list-style-type: none"> <li>More equal treatment of PDA for indirect uses across the EU</li> </ul>
	<ul style="list-style-type: none"> <li>Operating costs for businesses</li> </ul>	<ul style="list-style-type: none"> <li>Cost savings for users of PDA in MS that currently do not exempt indirect uses</li> <li>Reduced risk of disputes and associated costs in future</li> </ul>

➤ **LEGAL CERTAINTY AND FUNCTIONING OF THE SINGLE MARKET**

Improving the wording of Article 27(1)(b) would clarify the intended use and implications of so-called 'partially' denatured alcohol, thereby making the distinction with CDA (addressed in Article 27(1)(a)) clearer. While this would be unlikely to lead to any changes in the national laws transposing the Directive, or the way in which it is currently implemented, it may contribute to avoiding any possible future disputes or

misinterpretations by national authorities or economic operators concerning the correct treatment of CDA and PDA, respectively.

The clarification that indirect uses such as cleaning manufacturing equipment do indeed qualify for the exemption would require a small number of MS to adapt their approaches. Based on responses to the 2016 evaluation questionnaire, this would be the case for CY, EE, IT and SI, which currently only exempt direct uses, and may be the case for AT and LV (which did not respond to this question). A consistent approach across MS would pre-empt future disputes and associated costs, and put businesses across the EU on a more equal footing as regards this particular aspect.

#### ➤ **OPERATING COSTS FOR BUSINESSES**

Based on the interviews conducted for this study, most economic operators would typically prefer to use CDA for cleaning purposes due to the less strict controls, and therefore not experience any impacts from this option. However, in certain highly specific environments CDA is not suitable, or operators may use PDA as an ingredient of the product being manufactured and find it easier / less costly to use the same substance for other (indirect) uses as well.

In the (likely to be very limited) number of such cases where this is currently not possible due to the national interpretation of the terms 'used for the manufacture of', this option would result in modest cost savings, based on reducing complexities in terms of purchasing, storing and using different types of denatured alcohol as part of the same (wider) manufacturing process. The enhanced legal certainty would also reduce the risk of potentially costly disputes in future. These savings are not possible to quantify, as they are so dependent on the individual case.

### **3.2.8 Clarify what constitutes a 'product' containing PDA**

This addresses the problem that, reportedly, there are different interpretations between MS, or sometimes even different customs offices within MS, as to what can be considered a finished 'product' (and can therefore be exempted from excise duty and released for consumption) and what is still PDA (and therefore subject to the duty suspension regime until incorporated into a final product). The risk is that, if a liberal approach is taken, potentially large quantities of products with a high content of 'weakly' denatured alcohol are moved without any controls, which implies a fraud risk (and there is anecdotal evidence that in a few instances, products consisting almost entirely of alcohol have been purposefully declared under CN codes other than 2207 20, in particular 3820 or 3824, in order to facilitate their fraudulent use). On the other hand, the risk of a very restrictive approach is that genuine products with a high alcohol content and a non-existent fraud risk (e.g. fine fragrances) would also have to be moved under duty suspension.

Therefore, many national authorities and stakeholders are opposed to the idea of insisting that, in order to be eligible for the exemption, products have to in the form and packaging in which they are held out for sale, which would mean that products in bulk (e.g. in large tanks) would still be considered PDA and need to be moved under duty suspension. This interpretation was described as conceptually flawed (as the character of products should not be determined by their packaging, but by the degree of processing they have undergone), disproportionate (as, in principle, it would also apply to products containing only low concentrations of PDA), and difficult to enforce. In their OPC responses, the majority of stakeholders (60% of those who expressed an opinion) disagreed strongly with the notion that in order to benefit from the exemption, the product in question has to be a recognisable finished product *and* be held out for sale as such.

Finding an appropriate definition that would eliminate all uncertainty regarding what is and is not a finished product across product groups as diverse as cosmetics products and screen wash is very challenging. A solution to this problem could be two-fold:

- Reference to a 'recognisable finished product': This could be inserted into the Directive to provide further guidance as to the correct classification of goods. If the wording suggested under the previous option is used, the final sentence could read: 'Until the manufacturing process has been completed, *and the product in question is in its recognisable finished form*, the alcohol has to be processed, held, received and dispatched under a duty suspension arrangement in accordance with Directive 2008/118/EC'. While this form of words would not eliminate all uncertainty (as the term 'recognisable finished form' could still be subject to different interpretations), it would provide more clarity than is currently the case.
- Definition of a threshold above which the duty suspension regime applies: As an alternative or in addition to the above, a quantitative limit could be defined (and either inserted into the Directive, or, perhaps more appropriately, defined via a Commission Implementing Regulation and/or a note to the Combined Nomenclature (CN)) above which a product containing denatured alcohol always needs to be classified as 2207 20 00 (and therefore be considered an excise good and treated as such).<sup>396</sup>

Based on the information currently at our disposal, a limit of 90% ABV could be appropriate (but this would still have to be more systematically tested with stakeholders). A limit of 80% would also work for most products, and be more consistent with the current definition of CN code 2207,<sup>397</sup> but would be problematic as many fragrances contain over 80% ABV. Therefore, if an 80% threshold were to be used, an exception for fragrances would also need to be considered.

**Table 66 – Overview of impact areas of the proposed policy option on clarifying the concept of 'finished products' in Article 27(1)(b)**

Regulatory Option (Revision of Directive 92/83/EEC)	Impact areas	Nature of Impact Expected
<b>Clarify Article 27(1)(b) by inserting a reference to a 'recognisable finished product', and defining an ABV strength limit above which CN code 2207 20 always applies</b>	• Legal certainty	• Greater clarity as to when products containing PDA can be released for consumption • Reduced risk of divergent / arbitrary interpretations by customs offices
	• Single Market functioning	• More equal treatment of goods containing PDA across the EU
	• Operating costs for businesses	• Lower risk of delays / costs associated with disputes with customs • Potential movement cost increases for a limited number of products
	• Fraud risk	• Less scope for intentional misclassification of PDA so as to avoid controls

➤ **LEGAL CERTAINTY AND SINGLE MARKET FUNCTIONING**

This follows directly from the issues outlined above – as noted, the proposed clarification is expected to reduce the room for interpretation of the current rules, although it cannot eliminate it entirely, since the term 'recognisable finished product' could also leave room

<sup>396</sup> It should be noted that a similar approach has been taken to clarify the classification of mixtures containing ethyl alcohol used as raw material to produce fuels for motor vehicles. See Commission Implementing Regulations 211/2012 and 626/2014.

<sup>397</sup> Which includes: 2207 10 00 - Undenatured ethyl alcohol of an alcoholic strength by volume of 80% vol or higher; and 2207 20 00 - Ethyl alcohol and other spirits, denatured, of any strength.

for interpretation, albeit less so than the current situation. A more predictable and consistent classification of goods would, to a certain extent, lead to a more equitable treatment of goods across the EU, and thereby enhance the functioning of the Single Market for products containing PDA.

➤ **OPERATING COSTS FOR BUSINESSES**

The option would not have any impacts on the operating costs of the vast majority of businesses whose goods do not give rise to any doubts as to whether or not they represent finished products. However, in the case of certain legitimate products with a very high alcohol content that are frequently moved in bulk, in particular screen wash or anti-freeze, the combination of the clarified wording and quantified threshold should help avoid costs that may be accrued due to possible disputes with customs over their classification. It would also be advisable to consult producers of such goods specifically to confirm whether a quantitative threshold would be a cause for concern, i.e. whether it may mean legitimate products may be caught by it. If so, it would need to be considered whether the inherent fraud risk may nonetheless justify the option. For example, there is currently a German BTI<sup>398</sup> that clarifies a precursor ('*Vorprodukt*') for the manufacture of car screen wash consisting of more than 90% ethyl alcohol is to be classified as 3820. This is clearly not a 'recognisable finished product' in the sense discussed above, and there would therefore seem to be a case for it to be moved under duty suspension until it is transformed into screen wash as such.

➤ **FRAUD RISK**

This option is primarily a fraud prevention measure. The suggested limit of the alcohol content would give the authorities a potentially effective weapon to avoid the intentional misclassification of those goods that are most likely to be used fraudulently (such as the example referred to previously of shipments of 99% denatured alcohol and 1% soap). A potential weakness could be regarding products that are just below the threshold (e.g. 89% ABV), although it needs to be reiterated that these would only be considered as such if they are in their recognisable finished form.

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<sup>398</sup> BTI reference DE11134/11-1.

### 3.3 Reduced rates for small producers

#### 3.3.1 Introduction

This Section explores the policy options and presents the impact analyses concerning the three sub-problems identified in Section 2.3.2 above:

- 1) improving the functioning of reduced rates for small breweries, by assessing the effects of clarifying the definition of economic independence and the application of the scheme to cross-border operators;
- 2) improving the functioning of the reduced rates for small distilleries, by considering a higher output threshold;
- 3) extending the reduced rates to small producers of other beverages, namely wine, other fermented beverages, and intermediate products.

#### 3.3.2 Improving the functioning of reduced rates for small breweries

##### 3.3.2.1 Definition of the policy options

As discussed in the problem definition presented in Section 2.3.2, the main regulatory failures for small brewers concern (i) the existence of grey areas in the definition of independence; and (ii) the application of the provision to cross-border operators. On the contrary, no market or regulatory failures have been identified with respect to the current threshold, which is not considered to be distorting national markets, and which can be tailored by MS to their national specificities.

To address the problems described above, a **legislative revision** of the Directive could be foreseen. One possibility could be to introduce detailed norms into the main text of the Directive. However, given that the issues at stake require detailed rules – as opposed to general principle norms – it could also be appropriate to include these rules in Annexes to the Directive. For instance, Article 4 could be revised as follows.

##### Article 4

[...]

2. For the purposes of the reduced rates the term 'independent small brewery' shall mean a brewery which is legally and economically independent **(as defined in Annex I to the Directive)** of any other brewery, which uses premises situated physically apart from those of any other brewery and does not operate under licence. However, where two or more small breweries cooperate, and their combined annual production does not exceed 200 000 hl, those breweries may be treated as a single independent small brewery.

3. Member States shall ensure that any reduced rates they may introduce apply equally to beer delivered into their territory from independent small breweries situated in other Member States. In particular they shall ensure that no individual delivery from another Member ever bears more duty than its exact national equivalent. **Means for proving the status of small breweries are defined in Annex II to the Directive.**

There seems to be a limited need to further specify the conditions at which two companies should be considered as 'partners' or 'linked'. Other areas of EU legislation and the CJEU jurisprudence already provide for the necessary guidance, which has been developed and consolidated over the years. The Annex could provide a more articulated definition of 'independence' based on the existing legislation, guidelines, and jurisprudence. More in detail, any clarification of the conditions for independence would need to focus on the forms of cooperation which may breach the economic independence of small brewers. This would consolidate the current practices on beer brewed under

license – based on the Minutes to the Ecofin Council - on the present national practices, as well as on contract brewing.<sup>399</sup>

With respect to the means for proving the status of small brewers and the modalities for the exchange of information between tax or customs authorities,<sup>400</sup> these could be specified along different, possibly complementary, lines:

1. Ex-ante approach: all small brewers would be identified through a uniform certificate, designed at EU level, which would need to be presented when claiming reduced rates in a MS other than that of establishment. Such a certificate would state: (i) the brewery output level, as already communicated or available to the customs authority under tax warehouse obligations; and (ii) whether the brewer fulfils the criteria for economic and legal independence, based on additional documentation submitted by the operator. This certificate should be provided, upon request, by all customs authorities to all operators up to 200,000 hl, regardless of whether they can access reduced rates in their country of establishment.
2. Ex-post approach: as in the current framework, a verification of whether a non-domestic brewer meets the conditions for enjoying reduced rates would be done upon request of the authority of the MS of destination for specific players. However, these ex-post checks would be managed by means of an IT platform for the exchange of information, so that tax and customs authorities in the country of destination could inquire about an operator's annual output and independence. Alternatively, each customs authority could prepare a list of breweries which qualify for reduced rates under the national scheme, and/or breweries which are both independent and with an output below 200,000 hl.

As an alternative, these problems could be tackled by means of a **soft law instrument**, such as non-binding guidelines for the definition of economic independence or for the modalities for exchanging information on the status of small brewers. This solution would not require a legislative revision. The content of these guidelines would replicate what described above for the legislative revision.

Table 67 below provides the impact areas and target groups which are relevant for the option at stake. The revision is not expected to change the competitive conditions for small versus large producers or the overall consumption and price of beer, as it does not touch the most important drivers, such as the threshold and the rate of reduction. Hence, no intra-market effects, impacts on tax revenues, or health effects will be caused.

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<sup>399</sup> The Fiscalis discussion document also mentioned two other possible problems, which have not emerged from the fieldwork: (i) mixing of beer from different brewers, which happens sporadically in the small brewer segment; and (ii) brew shops, that are economic operators offering to private persons the possibility to brew their own beer by means of the operator's equipment. Both cases seem quite rare, and possibly limited to few MS (e.g., Denmark for brew shops). However, these and other aspects considered problematic by the MS could be usefully addressed by the intervention.

<sup>400</sup> In the various MS, the administration of the reduced rate scheme is managed by tax or customs authorities, or any other public authority entrusted to this purpose. In the remainder of the chapter, the term 'customs authorities' is used regardless of the national institutional setting to indicate either of them, as applicable.

**Table 67 – Overview of impact areas of the proposed policy option on reduced rates for small brewers**

Regulatory option	Impact areas	Nature of impact expected
<b>Clarification of the conditions to determine independence and of the application of reduced rates to cross-border operators</b>	• Legal certainty for economic operators and public authorities	• Improvement of the legal certainty for small brewers having certain contractual relations with other brewers
	• Administrative burdens for economic operators	• New administrative procedures for cross-border operators could affect administrative burdens
	• Enforcement costs for public authorities	• New administrative procedures for cross-border operators could affect enforcement costs
	• SME competitiveness	• Facilitation could enhance the growth of SME
	• Cross-border market effects for economic operators	• Easier access to reduced rates in countries other than that of establishment

### 3.3.2.2 Impact analysis

In this Section, the impacts of a clarification of the framework for small brewers are discussed. Given that the impacts are expected to be of a small scale, as the magnitude of the problem discussed is limited (see Section 2.3.1), the analysis is mostly done in qualitative terms. As presented in Section 3.3.2.1 above, the policy option could be implemented by means of a legislative revision or non-binding guidelines, and due attention will be paid when the choice of the instruments is expected to trigger different impacts. A comparison of the policy options with the *status quo* is provided in Section 4.3.1 below.

The analysis is carried out under the assumption that MS implementation will not change, i.e. that (i) MS providing reduced rate to small brewers, (ii) the national threshold, and (iii) the discount rate will remain the same.

#### ➤ LEGAL CERTAINTY

The clarification of the conditions at which a small brewer shall be considered independent will benefit to the public authorities called to implement these provisions, as well as to small brewers.<sup>401</sup> Indeed, should this clarification be introduced, it would be easier for public authorities and economic operators to determine whether certain business models or decisions are compatible with the reduced rate schemes.

Public authorities expressed a limited appetite for a revision of the Directive, or for non-binding guidelines. An intervention is considered appropriate if limited to the harmonisation of specific aspects of the definition of independence, such as contract brewing or other forms of cooperation. On their part, economic operators would be free to choose the most appropriate and efficient business model, comparing the benefits of certain forms of cooperation (e.g. make-or-buy decisions, outsourcing v. investment in internal capacity) while knowing whether they could retain or not the right to the reduced rate. For small brewers, this would reduce the risks connected to the entering into certain trade relationships, as well as the litigation costs associated to the cases in which the interpretation of the customs authorities will be challenged by the operator. Also, the discrepancies between MS, or between regions of the same MS – which have

<sup>401</sup> On the contrary, there is no issue of legal uncertainty with respect to the application of reduced rates to cross-border operators – the Directive already includes an explicit obligation for MS to this purpose, and problems are mostly linked to the application and enforcement of the procedure rather than to the Directive provisions. See below when discussing administrative burdens and enforcement costs.

been sporadically reported – will be tackled, reducing the risk of an uneven treatment of similar situations.

The choice of the means to introduce this policy option – hard versus soft law – would have impacts over the level of legal certainty achieved. A legislative revision would provide for a higher level of legal certainty in the short-term. However, the small brewers market is growing and evolving very fast at the moment, so that a definition ‘cast in stone’ could become outdated in the medium-term, or be circumvented by the introduction of ‘borderline’ business practices. The main drawback of a piece of soft-law would be that MS would retain the power to apply it or not. However, two considerations should be brought forward: (i) there is a certain consensus that these aspects present a degree of subjectivity, and that there would be a merit from further harmonisation; as such, expectation would be that the existing demand for clarification would enhance its application by national authorities; (ii) MS were already able to settle the issue of licensed beer without resorting to any binding legislation, based on the consensus of national authorities<sup>402</sup> and the minutes of the Ecofin Council. Given these considerations and in the context of such a revision, the net benefits of using a non-binding instrument would seem to outweigh those of a legislative revision.

➤ **ADMINISTRATIVE BURDENS AND ENFORCEMENT COSTS**

Any clarification to how reduced rates should be applied to operators established in a different MS than that in which the beer is released for consumption would affect the administrative burdens borne by economic operators and the enforcement costs borne by public authorities. The impacts are different depending on which of the two approaches described in Section 3.3.2.1 above is adopted, namely (i) the ex-ante issuance of a customs certificate to small brewers; and (ii) the creation of a platform to exchange information ex-post between customs authorities.

In the ex-ante approach, a uniform certificate issued by customs authorities upon request to any EU brewer with an annual output below 200,000 hl could serve as a means of proving the status of small brewer. Such a certificate could be designed at EU level, included in a binding norm, and would be accepted by all customs authorities in the MS of destination. Such a certificate should provide information on:

- 1) **The annual output.** This information is, in most cases, already available to customs authorities because of the record-keeping duties under the excise regime, or could be retrieved with limited efforts. Though some MS make reference to the current year output, referring to the previous year output seems an easier solution to implement, as this information is already available.
- 2) **The status of independent brewer.** In MS where reduced rates for small brewers are available, the host MS customs authority could verify whether the operator asking for the certificate already enjoys such a status by looking at its excise declarations. However, problems could emerge in countries where reduced rates are not established, or for operators who are not small brewers according to the national threshold, but who could benefit from reduced rates in the MS of destination.<sup>403</sup> In this case, the customs authorities would need to verify ex-novo if they fulfil the conditions for independence and this could create administrative challenges (discussed further below).

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<sup>402</sup> See ‘Fiscalis discussion document’, at p. 6-7.

<sup>403</sup> E.g. a British brewery with an output of 70,000 hl would not benefit from reduced rates on its domestic sales, but would if selling its product in France, where the reduced rates apply up to 200,000 hl.

Under this approach, companies which are already small brewers under national rules would incur limited enforcement costs – basically, the costs of requesting the certificate. Assuming that 20% of the operators in the sample MS engage in trade activities towards another MS where reduced rates exist, and considering one hour in total to retrieve the information, file the request, obtain the certificate, and transmit it to their local distributors, additional administrative burdens for the operators in the sample MS would amount to about EUR 13,000<sup>404</sup> - or 2% of the burdens estimated for the overall scheme.

The situation would be different for operators who are not small operators in their country (i.e. because larger than the national threshold, or because the MS has not opted for reduced rates). Therein, the brewer would need to prove his/her status as an independent economic operator, by submitting the customs authority the required company documents (e.g., copy of the company register, information on shareholding, company charter). Familiarising with this new information obligation, retrieving the documents and the information, filing the request and obtaining the certificate is estimated to require one person/day of a clerk. The population affected in the sample MS would include Italian small brewers as well as Austrian and British brewers producing less than 200,000 hl, but more than their respective national threshold. As above, it is assumed that 20% of Italian small brewers would engage in intra-EU trade. With respect to Austrian and British brewers, given their larger size, it is expected that 80% of them will engage in trade towards a MS with a higher reduced rate threshold. Administrative burdens for these players are estimated at about EUR 32,000, or 5% of the burdens estimated for the overall reduced rate schemes. All in all, additional administrative burdens seem to be limited, for this policy option, at 7.5% of those estimated under the baseline; they are summarised in Table 68 below.

**Table 68 – Administrative burdens linked to the uniform certificate for small brewers in the six sample MS**

	Estimated number of intra-EU traders	Admin burdens € '000	Share over total burdens from the scheme
Small brewers currently under the scheme	675	13	2%
Small brewers not under the scheme	180	32	5%
<b>Total</b>	<b>855</b>	<b>45</b>	<b>7.5%</b>

**Source:** Author's analysis.

Enforcement costs for public authorities considered to be modest, when dealing with operators already benefitting from reduced rates in their country of establishment. In the six sample MS, custom offices would have to issue maximum few hundreds of certificates per year to small brewers intending to sell their products in a MS where reduced rates are applied. It can be assumed that the certification of the information to be included would pose no problems for those operators already subject to the reduced rates in their home country. However, verifying the status of 'independent operator' for brewers currently not covered by the scheme, but with an output lower than 200,000 hl is likely to be more problematic. Indeed, customs authorities should (i) consider the documents and information provided by the operator; (ii) verify, on the basis of this information, whether the brewer fulfils the criteria set out in the Directive, in other parts of the EU *acquis*, and in the relevant secondary norms and circulars adopted at national level; and (iii) request additional information when needed, or carry out additional checks and verifications. Such a procedure could be particularly burdensome in the countries which have not implemented the reduced rates for small producers, and thus have limited

<sup>404</sup> A Business-As-Usual factor of 1 is used, since the obtainment of the certificate is not part of normal business practices.

acquaintance with the implementation of the definition of 'small operator' and no secondary norms or circulars drafted to this purpose.<sup>405</sup> In this context, a possible compromise would be for the customs authority to certify the output, and for the operator to self-certify the status of independent brewer – subject to the possible verification by the local customs office, on behalf of the customs authority, in the MS of destination. However, this possibility would encounter the resistance of those MS which already require a certificate and tend not to accept self-certification by small brewers. In any case, the feasibility for public authorities, and in particular for those of MS which have not opted in to the reduced rates, should be carefully considered when assessing the adoption of this approach.

The second approach, the ex-post verification of the status of small brewer in the context of customs control, would require no effort by the producer, and thus negligible administrative burdens. However, it would entail enforcement costs for customs authorities; in any case, it presents less challenges compared to the ex-ante uniform certificate. This approach would firstly require the setting up of an IT platform for the exchange of information, so that the status of an intra-EU trader could be easily and quickly verified. This platform could be complemented by national lists of independent small breweries, which could be used as first step of the verification process.

Impacts on administrative burdens for economic operators and enforcement costs for public authorities are invariant to the choice of the policy instrument, i.e. whether a legislative revision is proposed or non-binding guidelines are published. However, the choice of either one or the other approach would influence the determination of the policy instrument. Should a uniform certificate be introduced, a legislative revision would be needed, so that the format and content of the document could be fully harmonised at EU level. Should an ex-post customs verification system be put in place, this could be done by means of a non-legislative intervention (e.g. by means of coordination of national customs authorities, or through a Fiscalis project).

#### ➤ **OTHER IMPACTS**

Two other impacts should be mentioned for the completeness of the analysis, although their magnitude is likely to be negligible to low. An improvement in the legal clarity of the provision for cooperating breweries, and a smoothing of the procedures for intra-EU trade are a positive factor for the competitiveness of SME. In particular, this would benefit larger players across the SME population, which are more likely to enter into cross-border trade or into more complex contractual relations, favouring their business growth. At the same time, more ease of doing business for intra-EU traders could have a positive market effect for cross-border operators, and eventually result in an increase of intra-EU trade flows. However, the scale of the problem at stake is modest, meaning that the procedures to apply the reduced rates do not represent a high barrier to the functioning of the Internal Market. Hence, benefits are likely to be modest. The choice of either policy option – binding or non-binding intervention – would not significantly affect these impacts; the only risk, in case of non-binding guidelines, is that a lower take-up by MS would reduce the magnitude of the positive effects.

#### ➤ **STAKEHOLDERS' VIEW**

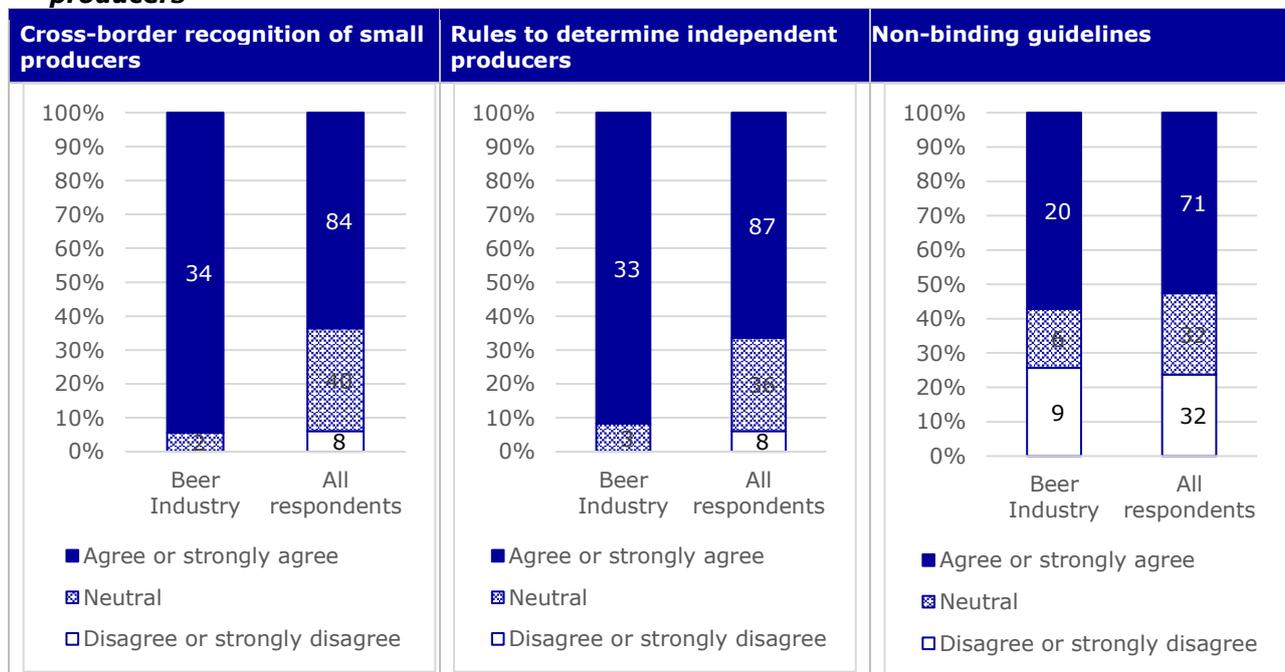
Respondents to the OPC agreed with the option clarifying the rules for the cross-border recognition of small producers, as well as the rules to determine when a producer is independent. The consensus is almost unanimous within the beer industry, where more than 90% of respondents are in favour of these changes, without significant differences between SME and other entities. Also taking into account the whole sample of

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<sup>405</sup> I.e. CY, IT, LT, and SE.

respondents, more than 60% of them agreed or strongly agreed with these options. The provision of non-binding guidelines while leaving the legislative text unchanged was also positively assessed by respondents, from both the beer industry and the overall sample. However, the support for non-binding guidelines was much milder, with about half of the respondents agreeing or strongly agreeing to this instrument.

**Figure 24 – Public view on the proposed policy options on reduced rates for small producers**



Source: OPC.

Note: 'Don't know' answers are not displayed.

### 3.3.3 Improving the functioning of reduced rates for small distilleries

#### 3.3.3.1 Definition of the policy options

As discussed in Section 2.3.1.1 above, the take up of the reduced rates for small distilleries is very low. This results from a combination of the limited number of MS applying the discount, as well as the low number of commercial operators falling below the threshold. The reasons why few MS opted in for the provision are manifold, including health policy, prevention of tax frauds, and costs for the public budgets. However, one of the reasons why MS did not opt in for this provision, and for sure the reason why very few operators could benefit from it even in those MS which did, is the level at which the threshold is currently set, which it too low.<sup>406</sup>

Here below, the policy option to raise the output threshold for small distilleries is analysed. More in detail, two variants of this option are explored. In the first one, in line with the rationale of the current provision, which protects traditional ancillary producers rather than operators at a significant commercial scale, the threshold could be increased from 10 hlpa to 100 hlpa per year. Such a threshold would cover only very small distilleries, but at a commercial scale of production. In the second option, the threshold could be brought in line with that of beer, at 10,000 hlpa per year.<sup>407</sup> This threshold

<sup>406</sup> This is also suggested by Spirits Europe's written contribution to the OPC.

<sup>407</sup> Considering the threshold for beer (200,000 hl) and an average beer strength of 5% ABV. This option would represent a radical change compared to the current situation. However, several stakeholders underlined the

would indeed cover small and medium distillers. Raising the threshold could be done only by means of a legislative revision. Table 69 below provides the impact areas and target groups which are relevant for the option at stake.

**Table 69 – Overview of impact areas of the proposed policy options for small distilleries**

Regulatory option	Impact areas	Nature of impact expected
<b>Raising the threshold for small distilleries up to:</b> <b>(i) 100 hpa</b> <b>(ii) 10,000 hpa</b>	<ul style="list-style-type: none"> <li>• Tax revenues for public authorities</li> </ul>	<ul style="list-style-type: none"> <li>• If more operators benefit from reduced rates, this would negatively affect tax revenues.</li> </ul>
	<ul style="list-style-type: none"> <li>• Market effects for economic operators</li> </ul>	<ul style="list-style-type: none"> <li>• Tax reduction could result in (i) substitution of consumption from large to small producers; (ii) increase of overall consumption of ethyl alcohol.</li> </ul>
	<ul style="list-style-type: none"> <li>• Administrative burdens for economic operators</li> </ul>	<ul style="list-style-type: none"> <li>• The increase in the number of operators concerned would increase total burdens.</li> </ul>
	<ul style="list-style-type: none"> <li>• Health impacts for consumers</li> </ul>	<ul style="list-style-type: none"> <li>• If consumption of ethyl alcohol is increased, this could increase overall consumption of alcohol per capita.</li> </ul>
	<ul style="list-style-type: none"> <li>• SME competitiveness</li> </ul>	<ul style="list-style-type: none"> <li>• Small distilleries below the threshold would enjoy an advantage compared to larger producers.</li> </ul>
	<ul style="list-style-type: none"> <li>• Enforcement costs for public authorities</li> </ul>	<ul style="list-style-type: none"> <li>• Public authorities would have to manage a larger number of operators claiming reduced rates.</li> </ul>

### 3.3.3.2 Impact analysis: small distilleries

In this Section, the impacts of a revision of the threshold for small distilleries are discussed. Unlike for beer, cider, and wine, data on the firm size distribution for distilleries and on their market share are scant. For this reason, the analysis is mostly qualitative, with quantitative examples or extrapolations when possible. A comparison of the policy option with the *status quo* is provided for in Section 4.3.2 below.

In line with the current wording of the Directive, the reduced rates for small distilleries would remain optional. The impacts of any revision would thus depend on the MS's choice to implement such an option. The analysis is carried out under the assumption that the sample MS for this policy issue would apply the exemption. Such a hypothesis will be discussed in the sub-section on stakeholders' view, further below.

#### ➤ MARKET EFFECTS, TAX REVENUES, AND HEALTH EFFECTS

Raising the threshold to 100 hpa would hardly generate any market impact. Even at this scale, the qualitative information collected and the data available show that the market covered by the reduction is likely to be minimal. In Poland, about 45 agricultural distilleries below 100 hpa are registered. Even assuming that they produce 100 hpa each, their market share would be around 0.4%. If Poland were representative of the sample MS, such a negligible market share would not distort competition between small and large producers, let alone the price and consumption of spirits. As a consequence, health impacts from the introduction of this provision would be negligible. The higher threshold would generate small additional costs for the public budgets. Based on the Polish example, total foregone revenues in the sample MS would amount to about EUR 17 mn, which is about 0.2% of the current revenues from ethyl alcohol.

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unevenness of the thresholds for small breweries and distilleries; this option is thus retained to identify the effects of fully redressing such an imbalance. See *i.a.* Spirits of Europe's written contribution to the OPC.

To the contrary, raising the threshold to 10,000 hlna would have a significant impact on the market. In mid-size countries such as Austria or Belgium, 10,000 hlna represent respectively 9% and 7% of the market for spirits. Even in larger countries, 10,000 hlna represent between 1% and 2% of the market. Table 70 compares the share of beer and spirit markets covered by a hypothetical firm producing 200,000 hl of beer or 10,000 hlna of spirits.

**Table 70 – Estimated market share of a hypothetical higher threshold for small distilleries, and comparison with the threshold applied to small brewers**

MS	Beer 200,000 hl	Spirits 10,000 hlna
AT	2.2%	9.0%
BE	2.5%	6.8%
FR	1.0%	0.7%
IT	0.5%	2.0%
PL	0.5%	0.9%
UK	0.5%	0.9%

**Source:** Author's elaboration, based on data from *Brewers of Europe* and *IWSR*.

**Note:** Belgium consumption includes Luxembourg.

The weight of excise duties over the price of spirits, which is considerably higher than in the case of beer, creates the risks that the advantages for small producers are excessive, hence possibly distorting the market for spirits. In the sample MS, the average weight of excise duties over one litre of spirits at 40% vol is between 25% in Austria and 49% in Poland.<sup>408</sup> It means that the tax advantage for a small distillery would range from 12.5% to 24.5% of the final price.<sup>409</sup> For beer, the share of excise duties over the average price is much lower, as it is comprised between 9% in Austria and 29% in the UK.<sup>410</sup>

Moreover, the costs for the public budgets would be substantial, and higher than in the case of beer. This is because the threshold would capture distilleries with a significant dimension compared to the national market, and because of the levels of the excise rate on ethyl alcohol.<sup>411</sup>

Finally, in the case of small brewers, most of the reduced rate benefited the producers and did not result in a reduction of the market price of beer. As such, health impacts were assessed as minimal. The pass-on mechanism for small distilleries could be different, because the tax discount over the price is higher. In a nutshell, while a small brewer would not be able to substantially reduce the price of its product, a small distiller could do so, given the higher tax burden. As such, the small distiller could have more incentives to pass-on part of the discount downstream, and gain in market share. Since the reduced rates currently cover only ancillary distilleries, this hypothesis could not be tested in the fieldwork, nor is it tested in the economic and business literature. However, if this were the case, the reduced rates would result in an increase in the consumption of spirits, with possible negative impacts on per capita alcohol consumption.

#### ➤ **SME COMPETITIVENESS, ADMINISTRATIVE BURDENS, AND ENFORCEMENT COSTS**

Should the threshold be raised to 100 hlna, this would hardly affect SME competitiveness. At the revised scale, the scheme would cover not only ancillary

<sup>408</sup> IWSR data (2015). Estimate not reliable for BE, due to the aggregation of BE and LU data in IWSR.

<sup>409</sup> Without considering the possibility to introduce brackets or a degressive system.

<sup>410</sup> IWSR data (2015). Estimate not reliable for BE, due to the aggregation of BE and LU data in IWSR.

<sup>411</sup> A quantification of foregone revenues is not possible given the lack of data on the number and volume of distilleries below 10,000 hlna.

producers, but also very small commercial players, which would pay lower excise duties and would be likely to increase their profit margins. However, the measure would not affect the majority of SME on the spirit market, as they would remain over the threshold. Enforcement costs for public authorities could also increase, given the larger number of companies benefitting from reduced rates that would need to be controlled. That said, distilleries are already controlled more tightly than other operators on the beverage market, and the amount of revenues at stake (as estimated above) is too small to require the deployment of additional resources from customs authorities. New operators falling below the threshold would need to incur administrative burdens to benefit from the reduction; however, as estimated for small breweries, these burdens are unlikely to be significant, and would be, by large, justified by the tax advantage.

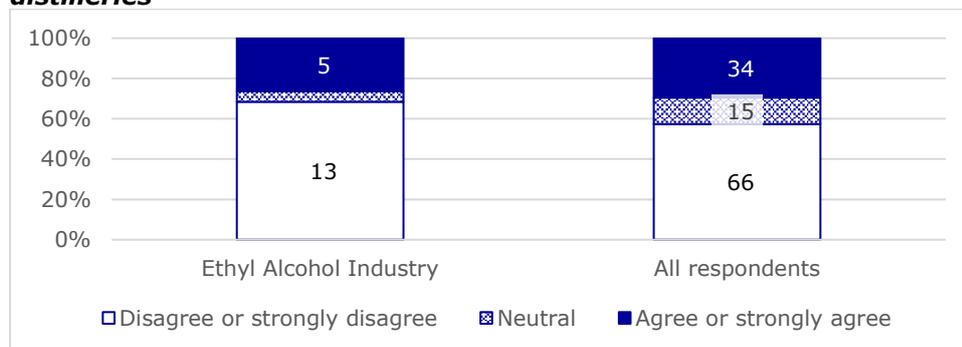
Should the threshold be raised to 10,000 hlpa, this would have large positive impacts on the competitiveness of SME in the spirit industry. Most, if not all of SME could have access to the scheme, and the reduction would represent a substantial boost. As a consequence of the larger number of operators covered by the reduction, total administrative burdens would increase but, as in the case of small breweries, the magnitude of these burdens would be limited and the benefits would justify the additional paperwork. Finally, additional enforcement resources should be spent to control the functioning of the system and limit the risk of abuses and tax frauds, because both the increase in the number of operators covered by the proposal, and the revenues at stake would become substantial. Hence, enforcement costs would increase significantly for public authorities.

➤ **STAKEHOLDERS' VIEW**

The working hypothesis that MS would implement the provisions on small distilleries should the threshold be raised at 100 hlpa or 10,000 hlpa seems far-fetched, based on the fieldwork carried out. Most of the authorities met expressed no desire for the revision of the threshold and no intention to implement an amended provision at national level. Reasons quoted against the possibility to implement the threshold at national level include health impacts and market distortions. Furthermore, most of the spirit economic operators and trade associations visited showed no or limited appetite for a higher threshold.

As regard the OPC, respondents generally expressed disagreement with the idea of raising the threshold for small distilleries. More than two thirds of the ethyl alcohol industry and an almost analogous share of other industry respondents disagreed or strongly disagreed with the proposal. A majority of SME in the ethyl alcohol sector was against the intervention. Only other respondents, and in particular private individuals, agreed to some extent to the proposal. Considering the overall number of respondents, negative views were expressed by a more than half of the sample.

**Figure 25 – Public view on a possible increase of the reduced rates threshold for small distilleries**



Source: OPC.

Note: 'Don't know' answers are not displayed.

### 3.3.4 Extending reduced rates to small producers of other beverages

#### 3.3.4.1 Definition of the policy options

As highlighted in the Commission Report, and in line with the mandates granted by the Council of the EU, this Study analyses the effects of the policy options extending the reduced rates also to producers of wine, other fermented beverages, and intermediate products. The new schemes would be based on what is already provided for small brewers and distilleries, hence on the following principles:

1. The reduced rates would remain optional for MS;
2. Access to reduced rates would be based on the definition of an 'independent producer';
3. Maximum yearly output thresholds for each fiscal category would be set in the Directive;
4. A maximum discount rate compared to the standard national rate would be fixed.

With respect to the conditions defining independence and the maximum discount, it is assumed that the new regimes would be in line with what already provided for small brewers and distillers. This includes both the provisions foreseen by the Directive (a player should be independent from a legal and economic point of view, and does not have to operate under license)<sup>412</sup> as well as the interpretation provided by the CJEU jurisprudence and the work at ITEG and Fiscalis level. As for the maximum discount rate, it is assumed that it would be set at 50% of the standard national rate.

With regard to the definition of the threshold, product specific considerations should be made.<sup>413</sup>

- For still wine, reference would be made to the threshold already used to identify small producers in the Horizontal Directive and in the agricultural *acquis*,<sup>414</sup> that is 1,000 hl per year.
- For cider, two choices are possible. First, the threshold could cover micro cider makers, i.e. ancillary producers only. In this case, it could be set at 100 hl per year.<sup>415</sup> Or, the threshold could cover small cider makers as well. Based on the fieldwork and the Consultants' analysis, it is suggested to apply a threshold covering not only ancillary producers, but also small cider makers. This preliminary choice is done considering that the market for cider is very similar compared to that of beer, with few industrial producers controlling more than 90% of the market and a large number of small operators. Hence, the rationale and coverage of the reduced rate regime should be similar. With regards to the exact output value, in the UK, the threshold dividing small- and large-scale producers is conventionally set at 15,000 hl,

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<sup>412</sup> The 'use of premises situated physically apart from that of any other operators' clause may pose problems for cider producers, since joint mills may be used by very small producers (including movable ones).

<sup>413</sup> To avoid unnecessary complexities, the analysis does not deal with the case of producers operating in more than one market. It is assumed that the threshold would apply independently, i.e. that an operator producing less than the maximum output of wine and of other fermented beverages would still have access to the reduced rates.

<sup>414</sup> See Article 22.b of Commission Regulation (EC) No 436/2009 laying down detailed rules for the application of Council Regulation (EC) No 479/2008 as regards the vineyard register, compulsory declarations and the gathering of information to monitor the wine market, the documents accompanying consignments of wine products and the wine sector registers to be kept.

<sup>415</sup> In the UK, the exemption from excise duties is granted to cider makers up to 70 hl. In Poland, a simplification of the excise regime is granted up to 100 hl. Also in Latvia, a simplified regime is foreseen for producers of fruit wine (and wine) with an output below 150 hl per year.

based on industry practice.<sup>416</sup> On the contrary, using the same threshold as for wine, i.e. 1,000 hl, would not be sufficient, because small cider producers are already beyond this threshold, and because of the different revenues generated by the same quantity of the two beverages. In the light of the above, it is suggested to base the analysis on a threshold of 15,000 hl.

- Producers of fortified wines are included in the wine sector for purpose of agricultural regulation.<sup>417</sup> As such, the threshold identifying a small producer of fortified wine is also set at 1,000 hl.

### **Box 26 – Regulatory costs issues for micro-cider makers**

Granting reduced rates would not address the risks that regulatory costs of being part to the excise framework are excessive for ancillary producers, i.e. farmers which are also micro-cider makers. Eliminating these burdens is the rationale of the cider maker exemption, which is in force in the UK, where micro-cider makers below 70 hl are fully exempted from the excise framework. In the context of this Study, it would be hard to justify the introduction of an exemption – as opposed to a reduction – for commercial producers only in the case of cider. Such an exemption would create problems in terms of uneven treatment of alcoholic beverages similar to those the Commission has been asked to assess and possibly redress. In any case, two possible avenues emerge as worth exploring, at national level: (i) introducing flat-rate schemes, such as those targeted to ancillary distillers in Austria, which relieve producers of most of the regulatory costs; or (ii) exempting micro-cider makers from most of the excise obligations via Article 40 of the Horizontal Directive, given that, based on Article 15 of Directive 92/83/EEC, all norms referring to 'wine' in the Horizontal Directive could be applied to 'other fermented beverages' as well.

The reduced rates would apply to the whole fiscal categories, and not only to the products discussed above, as in the case of small breweries and distilleries. This would mean that the threshold for still wine makers, cider makers, and producers of fortified wine would apply respectively to all wine products, other fermented beverages, and intermediate products. This assumption mimics the current structure of the reduced rates provisions, but should be further explored – for example, with the assumed thresholds producers of wine and wine-based aperitif would face different conditions. However, MS would remain free to apply the reduced rate to a subset of products within the same category, as they already do e.g. to cider and perry within the other fermented beverage category (e.g. UK and Poland), or to *vin doux naturel* within the intermediate product category (as in France), based on product definitions enshrined in their national legislation.

Table 71 below provides the impact areas and target groups which are relevant for the option at stake.

**Table 71 – Overview of impact areas of the proposed policy option on extending reduced rates to small producers of other beverages**

Regulatory option	Impact areas	Nature of impact expected
<b>Extension of reduced rates to small producers of:</b> <b>(i) Wine</b> <b>(ii) Other fermented beverages</b>	<ul style="list-style-type: none"> <li>• Tax revenues for public authorities</li> </ul>	<ul style="list-style-type: none"> <li>• The extension to new categories of producers would reduce excise revenues</li> </ul>
	<ul style="list-style-type: none"> <li>• Market effects for economic operators</li> </ul>	<ul style="list-style-type: none"> <li>• Intra-market effects: small operators would be subject to a lower tax burden than large operators</li> <li>• Inter-market effects: there would be an even</li> </ul>

<sup>416</sup> Discussing the threshold level with stakeholders, it was suggested that most of small producers, especially in traditional cider countries, would produce craft cider, which is made using fresh rather than concentrated juice – as much as small brewers are more likely to produce craft beer. The size of a craft cider maker is constrained by its production technique (i.e. the need to produce cider only when apples are available, rather than all year long – analogously to wine making), and could hardly go beyond 25,000 hl.

<sup>417</sup> See Article 1 of Regulation 479/2008 and Part XII of Regulation 1308/2013.

<b>(iii) Intermediate products</b>		treatment of small producers of different beverages
	• Public health impacts	• If consumption of alcoholic beverages is increased as a consequence of the lower taxation, this could have negative health effects
	• SME competitiveness	• Small producers would enjoy a tax advantage and their competitive position would be enhanced
	• Administrative burdens for economic operators	• Application for the reduced rates would generate administrative burdens
	• Enforcement costs for public authorities	• Management and verification of the new reduced rate schemes could demand additional enforcement resources

### 3.3.4.2 Impact analysis

In this Section, the impacts of the introduction of reduced rates for small producers of wine, cider, and fortified wine are discussed. A quantitative analysis is provided for both wine and cider, while a qualitative analysis is provided for fortified wine. A comparison of the policy options with the *status quo* is provided for in Section 4.3.3 below.

In line with the current wording of the Directive, the reduced rates for small producers would remain optional. The impacts of any revision would thus depend on the MS' choice to implement the options. The analysis is carried out under the assumption that the MS would apply the exemption. However, such an assumption may prove unrealistic, and further elaboration is discussed in the sub-sections on stakeholders' view.

#### ➤ **SMALL WINE PRODUCERS**

##### • **Market effects, tax revenues, and health effects.**

At EU level, a reduced rate for small producers of still wine would have a limited effect, because most of the still wine consumed in Europe is not excised. Indeed, still wine is subject to a zero or near-zero rate in 15 MS, representing 98% of still wine production and 78% of its consumption. On the contrary, MS applying a positive and non-negligible tax rate represent about 22% of the EU still wine consumption; hence, considering an average market share for small producers of 17%,<sup>418</sup> about 4% of the EU still wine market would be significantly affected by the reduced rates.

In zero or near-zero rate countries, the introduction of reduced rates would bring no tax advantage for small producers *vis-à-vis* large producers,<sup>419</sup> the relative competitive position of drinks would not change, and there would be no costs for the public budget. The situation is obviously different in countries applying a positive rate. Among the sample MS, effects would materialise in Belgium, France, Poland, and the UK, and are summarised in Table 72.

<sup>418</sup> Based on the market share of small producers below 1,000 hl in the 6 MS visited in depth.

<sup>419</sup> At least for domestic sales.

**Table 72 – Tax impacts from reduced rates for small wine producers**

	Excise Rate	Excise rate as a share of average price	Market for still wine*	Revenues from still wine*	Foregone revenues from the reduced rates	
	€/hl	%	hl	€ mn	€ mn	%
<b>BE</b>	74.91	10%	2,122,313	147.62	13.5	9%
<b>FR</b>	3.77	1%	11,362,681	92.44	7.4	8%
<b>PL</b>	36.80	3%	1,057,050	89.54	3.3	4%
<b>UK</b>	318.20	27%	10,680,570	4693.96	288.9	6%

**Source:** Excise rate and revenues: EDT; Price and consumption: IWSR.

**Note:** BE market data includes LU; PL revenues include sparkling wine. (\*) market data and overall revenue data are drawn from different sources, and minor differences are possible. MS applying a zero rate are not analysed.

Foregone revenues would be significant for the UK, at about EUR 300 mn; in relative terms, they would be the highest in Belgium, at about 9% of the excise revenues of still wine. At EU level, total costs would amount to around EUR 440 mn, or 7% of excise revenues from wine; the UK, with its large market and high rate, would thus bear two thirds of these costs. After the UK, costs would be the highest in the Scandinavian countries, in Ireland, and the Netherlands, in the EUR 15-45 mn range.

In terms of market competition, the competitive position of small wine producers would gain relatively to both large wine producers and producers of other beverages, both if they were able to undercut their price or to increase their profits thanks to lower duty rates. With respect to inter-market effects, it is important to underline that the bulk of the gains would accrue to foreign producers: as the countries with a non-negligible excise rate on still wine represent only 3% of still wine production, but 22% of its consumption, foreign small producers of still wine would gain relatively to local producers of other alcoholic beverages.<sup>420</sup> While this is, in principle, irrelevant for this impact analysis, which does not consider distributional impacts between domestic and foreign players, this factor is relevant for the likelihood of the uptake of this provision, discussed further below. Importantly, due to the WTO non-discrimination principle, the provision would also apply to third-country operators. Imports of wine is a significant part of the market: in 2015, the EU imported about 14 mn hl of wine, or about 9% of total consumption.<sup>421</sup>

For both intra-market and inter-market competition, the size of the advantage enjoyed by small producers depends on the weight of the excise burden over the average price. In France, Belgium and in Poland, the situation is similar to what was described for beer, i.e. still wine is subject to relatively low taxation; as a consequence, the tax advantage would not represent a significant market distortion. On the contrary, in the UK, where the excise burden amounts to 27% of the average price, the tax advantage for small still wine producers would be substantial, and the norm could thus be distortive.

Adverse health effects at EU level would be limited, because the market share significantly affected by the reduction – less than 4% – is too limited to result in an increase of wine consumption. However, in countries with a relatively higher taxation on still wine (such as Scandinavian countries, Ireland and the UK), the market distortion is expected to be significant, and as such it could trigger additional wine consumption, with uncertain effects on overall per capita alcohol consumption, depending on the rate of substitution with other beverages.

<sup>420</sup> Excluding France, where the gains are limited given the current excise rate level.

<sup>421</sup> DG AGRI, 'Dashboard Wine' and 'Extra-EU trade', 2016.

- **SME competitiveness, administrative burdens, and enforcement costs.**

The competitiveness of small wine producers would be positively impacted by such a norm, but the magnitude of impacts would be limited and concentrated in specific countries or groups of SME; in particular, the norms would produce uneven effects on the SME involved in the wine value chain:

- (i) First, the reduced rates would benefit only the small producers located in countries with a non-negligible excise rate on still wine, or those selling in these countries. The former group represent a negligible share of the SME in the wine sector. As for small producers selling their wine abroad, those are likely to be the largest in their cohort or those operating in high-quality niches, given that entering other EU markets is more difficult and relatively costlier for very small wine makers. As a consequence, the provision would have a beneficial effect on the entry rates in countries where the production of wine is very limited, and on the growth and competitiveness of a small part of the SME only.
- (ii) The competitive advantage would be limited to wine makers, excluding other small operators which do not vinify on their own, such as those who confer their output (grape, juice or bulk wine) to larger wine makers, cooperatives or *negociants*.

In terms of administrative burdens, it is assumed that the burdens per company would be similar to those incurred by small brewers. In the sample MS, average annual burdens per company are thus evaluated at EUR 178. The population potentially covered by the provision is estimated at about 135,000 small producers.<sup>422</sup> However, only a small part of them would be concerned, i.e. those established in MS with a non-negligible positive tax or selling their products therein. Based on the share of consumption of these countries, it is assumed that the provision would affect 22% of the universe, i.e. about 30,000 still wine producers. Total burdens are thus assessed at EUR 5.3 mn; considering that the market share of small producers in these MS is estimated at about 9.1 mn hl, the average cost per unit of production amounts to 1.2 €/hl. Such a burden is higher than in the case of small brewers, due to the very large population of small wine producers concerned, but still negligible when compared to the average price of wine.

The enforcement of this provision cannot be expected to be as smooth as in the case of beer. While in the case of beer cross-border trade is more the exception than the rule, in this case most of the still wine on which the reduced rate should be applied comes from foreign MS. This means that local customs authorities would have no means to directly control the independence and the output of the wine makers claiming the reduction. Enforcement would thus be more complex, in particular if the additional provisions considered for cross-border small brewers (i.e. the uniform certificate for small producers and/or a platform for the exchange of information) were not introduced. Also, the enforcement would be particularly difficult with respect to third-country small operators, which represent a non-negligible part of the market (9% at EU level, and even more so in non-producing countries where wine is subject to positive duty rates).

➤ **STAKEHOLDERS' VIEW**

The risk of positive rates explains by far and large why several tax authorities and most of trade associations were against the option,<sup>423</sup> with the exception of those representing small producers only. In the view of these stakeholders, the introduction of reduced rates for small producers is only the first step in mandating positive tax rates for wine, an outcome which would negatively affect all operators, both large and small.

<sup>422</sup> Based on the number of small producers estimated in the 6 MS covered in-depth, and their share of production over total EU production.

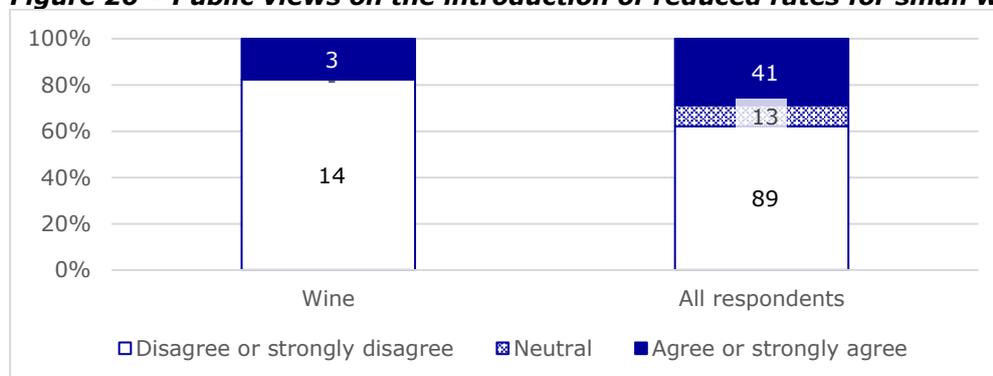
<sup>423</sup> 95% of respondents to the OPC from the wine industry considered this risk as likely or very unlikely (against 59% among all respondents). See i.a. the contribution of CEEV to the OPC.

In addition, generally speaking, MS which produce wine do not tax it; MS which tax wine do not produce it. As a consequence, it would be difficult to imagine that MS would decide to implement a tax break, which will benefit only or mostly foreign small producers and not local ones. Findings from the fieldwork were in line with this conclusion, as very few tax authorities expressed support for the extension of reduced rates to small wine producers, mentioning that they already enjoy significant advantages, such as the zero rate and the simplifications provided by the Horizontal Directive. The provision would become relevant, and thus more likely to be implemented, only if a positive EU minimum rate or positive national rates were imposed on wine.

When discussing reduced rates with small wine makers engaging in intra-EU trade, the main perceived obstacle is not the level of duty rates, which does not create any competitive distortion between domestic, foreign, small, or large players. Rather, they were concerned with the procedures of paying excises in the MS of destination. However, this aspect is not regulated under Directive 92/83/EEC. As a consequence, it is extremely unlikely that trade associations and economic operators in the wine sector would demand for reduced rates, even if they were introduced in the Directive.

As for the views from the OPC, they generally expressed disagreement with the idea of introducing reduced rates for small wine producers. On the one side, the industry perceived the risk that reduced rates for small producers could become a *trojan horse* for positive rates; on the other side, the other sectors were concerned that the relative position of wine makers, which are already at an advantage in their view, would be further enhanced. As a consequence, more than 80% of respondents from the wine industry and more than 62% of all respondents expressed disagreement with such an option. Considering all respondents, a majority of them disagreed to some extent with the extension.

**Figure 26 – Public views on the introduction of reduced rates for small wine producers**



**Source:** OPC.

**Note:** 'Don't know' answers are not displayed.

➤ **SMALL CIDER MAKERS**

- **Market effects, tax revenues, and health effects.**

The analysis in this Section is based on 5 MS: France, Ireland, and the UK, each of them having a large cider market and production, as well as Poland and Italy, two marginal producers and consumers. These 5 MS represent 72% of the cider consumption in the EU.<sup>424</sup>

<sup>424</sup> Based on AICV data.

The minimum rate for cider (and other fermented beverages) is set at zero as for wine. However, the number of countries where still and sparkling cider are subject to zero rate is lower than in the case of wine (9 MS).<sup>425</sup> Most importantly, the largest markets have a positive tax rate: the 9 MS in which still and sparkling cider are not excised represent only 9% of cider consumption.<sup>426</sup> Among the countries covered in-depth, only Italy applies a zero excise rate on cider.

The market structure and the value chain for cider are different from those of wine, and much closer to those of beer. In most countries, cider makers are not intermingled in complex relationships, and small cider producers make cider themselves, rather than providing intermediate products to larger companies.<sup>427</sup> In terms of market structure, micro and small cider makers represent the vast majority of the population (96% in the UK, 99% in France, 93% in Ireland), but a small share of the market. Only in France, small and micro cider makers are estimated to represent about 20% of the market; in both UK and Ireland, about 97% of the market is in the hands of a few large industrial producers. In the sample analysed, the market share of small producers is estimated at 4.6%.

Table 73 below presents the excise burden over the average cider price, and the costs for the public budget of a 50% reduced rate for small producers, based on small cider makers representing 4.6% of the market. Foregone revenues due to this option are unevenly distributed. Impacts on tax revenues are very small in Poland, due to the dimension of the cider market, as well as in France, where the excise burden on cider represents only 1% of the price; on the contrary, they are significant in the UK and in Ireland, where markets are large and taxation – especially in Ireland – is higher.<sup>428</sup> Extrapolating from these 5 MS to the EU level,<sup>429</sup> total foregone revenues are estimated at about EUR 15 mn.

**Table 73 – Tax impacts from reduced rates for small cider makers**

	Excise Rate	Excise rate as a share of average price	Market for cider	Overall excise revenues	Foregone revenues of the reduced rates
	€/hl	%	hl	€ mn	€ '000
FR	1.33	1%	822,500	3,256	25
IE	94.46	19%	625,000	1,137	1,358
PL	22.59	6%	80,000	2,588	42
UK	44.52	7%	9,500,000	14,441	9,727

**Source:** Excise rate and revenues: EDT. Cider market: AICV (national association for PL). Cider price: IWSR.

**Note:** MS applying a zero rate are not analysed.

In terms of market competition, small cider makers would gain relatively to large ones, either because they are able to reduce their price or increase their profit margins (or a combination of both). The reduction would allow compensating for higher costs of production due to diseconomies of scale, which mirror those suffered by small brewers. The sheer difference in size between industrial producers and small cider makers, and the very small market share retained by the latter imply that reduced rates would hardly represent a significant competitive threat for large players. The situation could be different for France, where small players control about 20% of the market; however, the

<sup>425</sup> Considering still cider only, it is subject to zero rate in 13 MS.

<sup>426</sup> Excise data from EDT; consumption data from AICV, 'European Cider Trends 2016 - Update' (data from national association for PL). The 13 MS in which still cider is not excised represent 14% of cider consumption.

<sup>427</sup> France is an exception, as cooperatives play an important role in the production of cider.

<sup>428</sup> Unlike in the analysis done for wine, it is not possible to compare the costs of the reduction with the excise rates from cider or other fermented beverages, because of the lack of disaggregated revenues statistics. Obviously, when expressed over total excise revenues from alcoholic beverages, the impact of this provision is minuscule (higher than 0.1% of current revenues only in Ireland).

<sup>429</sup> Based on the EU market share represented by these MS.

taxation is so low therein, that they would enjoy a negligible tax advantage. At the same time, small cider makers would gain also relatively to other small producers, both if they undercut their price or increase their profit margins, and in particular to small brewers, who can have access to reduced rates in 23 MS.

The effects on per capita alcohol consumption, and consequently negative health impacts, are expected to be negligible. The portion affected by the extension, estimated at 4.6% of the cider market, is too small to affect the overall price and consumption of cider. In addition, cider represents a relatively smaller market compared to other alcoholic beverages in most of MS. Only countries with a very large cider market – mostly, the UK and Ireland – could see noticeable negative health effects, if deciding to introduce the reduction.

- **SME competitiveness, administrative burdens, and enforcement costs.**

The competitiveness of SME in the cider industry would be enhanced by the provision. Impacts could be estimated to be analogous to those enjoyed by small breweries, given the similarities in terms of market structures. As such, it can be expected that the provision would increase the profitability of small players, and allow them to offset the cost disadvantage due to their smaller scale of production. In most MS, unlike wine, all small operators in the cider market would benefit from this provision. The provision would not ensure the viability of ancillary producers, for whom the regulatory costs of being part to the excise framework are a higher barrier to entry than the duties payable.

As far as administrative burdens are concerned, it is assumed that the annual burdens per company would be similar to those incurred by small brewers, estimated at EUR 178. The EU population potentially covered by the provision is estimated at about 1,145 small cider makers.<sup>430</sup> Total burdens are thus estimated at about EUR 200,000. Considering the market share of small cider makers in MS applying a positive tax rate, and thus potentially affected by the provision, costs per unit of production would amount to 0.32 €/hl.

Finally, in terms of enforcement costs, public authorities would have to deal with a new scheme, and thus with the associated demands/self-certification to obtain the reduced rates. This would engender additional costs, but the number of players at stake is so limited that those costs would not be large. Problems could emerge with respect to cross-border operators, but, given the much smaller size compared to small brewers, intra-EU trade of cider, potentially benefitting from the reduced rates, is estimated to be marginal.

➤ **STAKEHOLDERS' VIEW**

The implementation of the reduced rates for cider should not be expected to be large, because the consumption of cider is concentrated in a few national markets, and because 9 MS already foresee a zero rate for both still and sparkling cider. However, in most of the conspicuous markets, cider is taxed, so that there would be scope for a tax reduction. Tax authorities either welcomed or did not oppose the possibility of granting reduced rates to small cider makers.

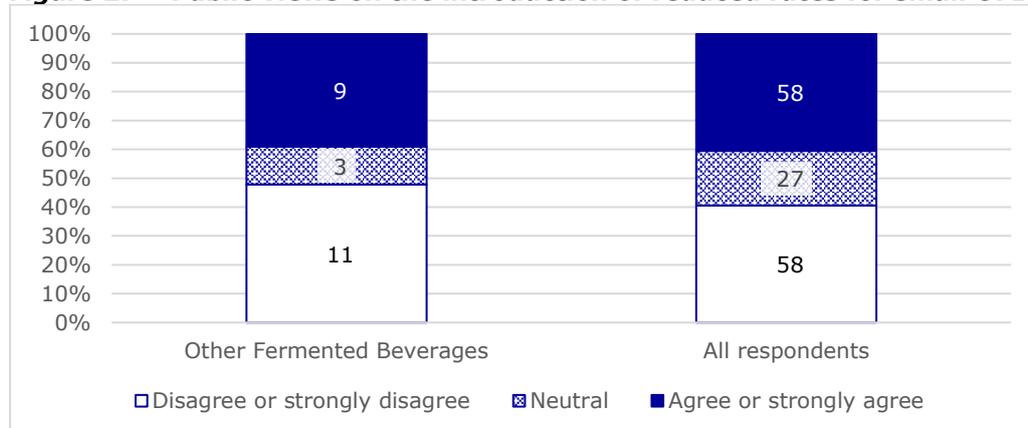
The respondents to the OPC provided a split view on whether reduced rates should be extended to small producers of other fermented beverages, with producers of other fermented beverages (or representative thereof) somehow more negative than others.

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<sup>430</sup> Based on the number of small producers estimated in the 5 MS covered in-depth, and their share of consumption over total EU consumption.

However, industry responses should be considered cautiously, because only one respondent out of 31 is active exclusively in the other fermented beverages market.

**Figure 27 – Public views on the introduction of reduced rates for small OFB producers**



Source: OPC.

Note: 'Don't know' answers are not displayed.

### ➤ SMALL PRODUCERS OF FORTIFIED WINE

Data on the production and market of fortified wine do not allow for any quantitative analysis. In qualitative terms, the impacts of applying the reduced rates would be as follows:

- 1) Many small wine growers or wine makers operate in the value chain of fortified wine (e.g. 30,000 only for Port); however, most of them provide their juice or bulk wine to shippers, or *bodegas*, and hence are not producers of fortified wine. As a consequence, they would not be the direct beneficiaries of this reduction. Hence, as in the case of wine, the reduced rates would affect unevenly small companies in the fortified wine value chain, depending on the scope of their activities.
- 2) When considering producers of fortified wine, small producers below 1,000 hl would have a limited market share. For this reason, the reduced rates, as in the case of beer or cider, would not affect a large part of the market; as a consequence, they would cause small losses in terms of tax revenues, and they would unlikely alter market equilibria, thus not affecting price and consumption of fortified wine (let alone other alcoholic beverages). Impacts on per capita alcohol consumption, and thus negative health effects from this reduction, would be negligible.
- 3) Market distortions depend on the duty rate applied in each country to intermediate products and on its weight on retail price. Among the sample MS, the impact of excise on average price varies: less than 10% in Austria, Italy, and Poland, between 10% and 20% in France and Belgium, and above 30% in the UK.<sup>431</sup> Where the excise burden is low, the discount would thus be unlikely to introduce a significant market distortion. Importantly, discounted rates for specific products, not tied to the size of their producers, already exist in countries where the production and consumption of fortified wine are significant, such as for *vin doux naturel* in France (75% discount compared to the standard rate) or for *Vinho de Madeira* in Portugal (51% discount).<sup>432</sup>

The likelihood of uptake of reduced rates for fortified wine is higher than in the case of

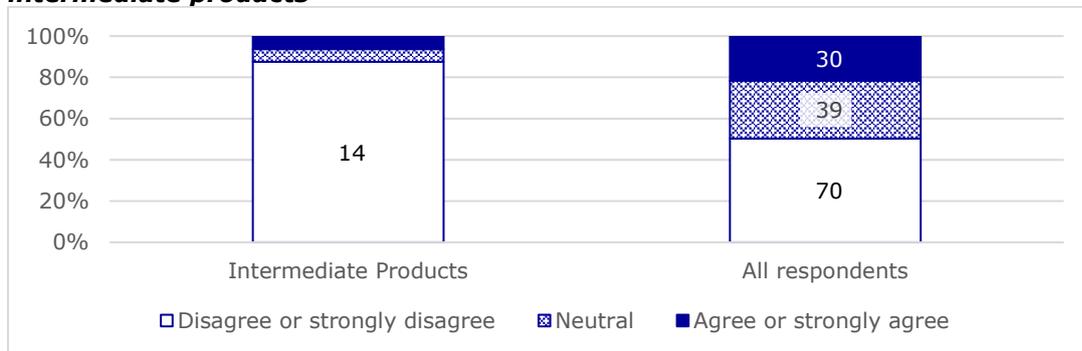
<sup>431</sup> Source: EDT for excise rates; IWSR to calculate average price.

<sup>432</sup> EDT.

wine for two reasons. First of all, there is a positive minimum tax rate for intermediate products. Secondly, markets for fortified wine are larger in producing countries, so MS could have the possibility to favour local small producers. The five most important intermediate wine producing countries (Spain, Portugal, Italy, Greece, and France) represent about 65% of the EU market.<sup>433</sup>

Finally, with respect to the public view on the proposed policy option, responses from the overall sample and from producers of intermediate products are shown in Figure 28. Disagreement with respect to the policy option was widespread within the industry, much more than in the overall sample. However, out of 23 operators or trade associations active in the intermediate product market, only 4 of them produce exclusively intermediate products, hence this opinion should be considered cautiously. Compared to wine, the overall assessment of this option was slightly more positive, even though half of the respondents still disagreed with it.

**Figure 28 – Public views on the introduction of reduced rates for small producers of intermediate products**



**Source:** OPC.

**Note:** 'Don't know' answers are not displayed.

<sup>433</sup> IWSR data.

### **3.4 Reduced rates for low-strength alcohol**

In Section 2.4 we have analysed the extent to which the relatively low uptake of reduced rates for low-strength alcohol among MS is somehow connected to a lack of clarity on its purpose, in order to establish whether there is the need to re-state – e.g. via guidelines – the nature and magnitude of expected effects. The results of our analysis is that such intervention is not justified. In fact, various stakeholders (both national authorities and economic operators) have stressed that such guidelines would be both non-requested and ineffective: MS would continue applying reduced rates for low-strength alcoholic beverages based on different (sometimes combined) national priorities. For instance, guidelines stating that these provisions are intended to support public health policy targets would have no practical effects in those MS where taxation policy and health policy on alcohol are strictly separated nor in those where such provisions have already been implemented for public health purposes. In addition, the selection of targets/objectives would involve a high degree of uncertainty as there is limited evidence of public health impacts of such provisions, even in those MS where reduced rates for low-strength alcoholic beverages are applied. The only type of guidance that some stakeholders would consider effective would point at using reduced rates to approximate a system where alcoholic beverages are taxed based on their actual alcohol content – a view that is however opposed by several other MS authorities and stakeholders. The lack of interest in a formal clarification of the objective of these provisions is also confirmed by OPC results, with more than half of respondents either having no or neutral opinion and about 30% disagreeing with it. This option is therefore not assessed in the Study.

Based on the baseline assessment, it seems instead useful to examine the possible impact of increasing the threshold for low-strength alcohol for beer as well as for wine, intermediate products and ethyl alcohol. As discussed in Section 2.4 it is useful to separate beer (option 1) from the other products (option 2) since the functioning of reduced rates and the level of demand is significantly different.

As a general consideration it is important to underline that reduced rates would remain an optional measure and that thresholds represent maximum upper limit, so MS currently not applying reduced rates may continue doing so, and MS applying reduced rates may maintain their current thresholds, even if the EU-level maximum thresholds have increased. In these circumstances, a policy amendment would not necessarily translate into a policy change (and concrete impact) at MS level.

#### **3.4.1 Revised threshold for low-strength beer (option 1)**

##### **3.4.1.1 Definition of the policy option**

To increase the relevance of the threshold identifying low strength-beer and provide incentives to produce/consume this type of beer, option 1 aims to amend Article 5(1) of the Directive and allow MS to apply reduced rates to beer with an actual alcoholic strength by volume not exceeding 3.5% vol (instead of 2.8% vol).

This option is expected to generate impacts in terms of: (i) tax revenues, as larger shares of the market could benefit from reduced rates compared to the baseline; (ii) market effects, as lower taxation may lead to lower price for low-strength beer, hence an increase in demand; and (iii) ambivalent public health effects, as increased consumption of low-strength beer may (or may not) reduce the per capita intake of alcohol and, through higher availability, may increase the number of alcohol consumers, particularly among young people.

**Table 74 – Overview of impact areas of the proposed policy option on revising the low-strength threshold of beer**

Policy Option	Impact areas	Nature of Impact Expected
<b>New threshold to apply reduced rates to low-strength beer set at 3.5% vol.</b>	<ul style="list-style-type: none"> <li>• Tax revenues (in MS applying reduced rates)</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in tax revenues from consumption of beer</li> </ul>
	<ul style="list-style-type: none"> <li>• Market effects (for brewers of low-strength beer)</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in price and increase in consumption of low-strength beer</li> <li>• New market opportunities/product innovation stemming from revised thresholds</li> </ul>
	<ul style="list-style-type: none"> <li>• Public Health</li> </ul>	<ul style="list-style-type: none"> <li>• Change in consumption of low-strength beer may generate ambivalent public health impacts</li> </ul>

### 3.4.1.2 Impact analysis

#### ➤ IMPACT ON TAX REVENUES AND MARKET EFFECTS

Tax revenues and market effects generated by option 1 depend on four main factors: i) the (actual/potential) size of the market for beer not-exceeding 3.5% vol; ii) the number of MS that will decide to apply reduced rates to beer below 3.5% vol; iii) the reduced rate applied to beer below 3.5% vol; and iv) the extent to which the discount is passed-on to the consumer. For all factors, some assumptions are required to perform an impact analysis.

As for the first factor, currently there are no statistics available to measure the size of the market for beer between 2.8% vol and 3.5% vol. In Finland, whereas in 2015 the share of the market below 2.8% vol corresponded to 1.6% of the total market for beer (see Figure 9 above), 94.4% of the beer consumption was comprised in the bracket 2.9-4.7% vol.<sup>434</sup> Based on stakeholders' feedback, the distribution of the consumption in this bracket is not homogenous; in fact, the bulk of the market is just below 4.7% vol, which is the maximum threshold for off-trade sales in standard stores.<sup>435</sup> In the UK, data from 2009 pointed at a 1.2% market share for beer between 1.3% vol and 3.3% vol and a 61.9% share for beer between 3.4% vol and 4.1% vol;<sup>436</sup> ales tended to vary across the latter range (3.4-4.1% vol), while major lager brands were above 3.8%, with the average beer strength at 4.19% vol. A survey conducted by UK Society of Independent Brewers in 2016 led to similar results<sup>437</sup>: the average beer strength was 4.2% vol, there was no bestselling beer below 3.4% vol and only five independent brewers out of 344 respondents to the survey reported that at least 40% of their production was in the bracket 2.9%-3.4% vol. In countries where reduced rates are not applied to beer, statistics on consumption of beer by alcohol content are not available. Based on stakeholders' feedback, the Belgian market is historically dominated by special beer and there is almost no market for beer below 4.1% vol, except for radler that is generally below 2.8% vol. Similar considerations apply to Romania, where there is no demand for low-strength beer and even radler is losing momentum. In Italy and in Poland<sup>438</sup>,

<sup>434</sup> For further details see Panimoliitto, 'Domestic sales of beer, cider, and long drink (and soft drink) 1990-2016', <http://www.panimoliitto.fi/app/uploads/2017/03/Kotimaanmyynti-1990-2016.pdf> (last accessed on 30 June 2017).

<sup>435</sup> Alcoholic beverages above 4.7% vol are only retailed by Alko, the national alcoholic beverage retailing monopoly in Finland (for further detail see <https://www.alko.fi>; last accessed on 10 July 2017). In this respect, some stakeholders have emphasised that the threshold banning sales in stores is more effective than any tax discount.

<sup>436</sup> For further details see BBPA, 'Government review of alcohol taxation', 2010, at: <http://s3.amazonaws.com/bbpa-prod/attachments/documents/resources/21180/original/BBPA%20Response%20to%20review%20of%20Alcohol%20Taxation.pdf?1328114934> (last accessed 10 July 2017).

<sup>437</sup> For further details see SIBA, 'British beer', 2017, at: <http://www.siba.co.uk/SIBAMembersSurvey2017FINAL.pdf> (last accessed on 10 July 2017).

<sup>438</sup> Where it is forbidden to sell alcoholic beverages above 3.5% in large public events.

instead, large producers are recently launching beer with 3-3.5% vol alcohol content, yet it is too early to capture the market share of such products.

Against this background, it is apparent that the market share for low-strength beer between 2.8% vol and 3.5% vol across all MS is modest; nonetheless, it is reasonable to assume that the adoption of the 3.5% threshold would develop a new market 'niche' immediately below this limit. In what follows, this new market niche is assumed to be comparable in size to the current market for beer ranging between 0.5% vol and 2.8% vol.

Whereas some estimates are possible with regard to the first factor, it is more difficult to predict the MS' reaction to a change in the threshold defining low-strength beer. In fact, it is uncertain whether: i) MS currently applying reduced rates would accommodate an increase in the threshold; ii) MS not currently applying reduced rates would implement the provision allowing for a higher threshold. In addition, there are no indications about the level of the reduced rates that MS would introduce. In what follows, and for analytical purposes, 'full-compliance' is assumed, i.e. all sample MS would introduce reduced rates for low-strength beer not exceeding 3.5% vol. In this context, reduced rates for Belgium, Italy, Poland and Romania are assumed to be 50% of standard rate. As these countries compute tax on beer by applying the Plato method, for the sake of simplicity one Plato degree is assumed to be equal to 0.4% vol.<sup>439</sup>

Finally, with regard to the pass-on rate, it is assumed that reductions in the payable excise duty are 100% passed on to consumers. This can be considered an average pass-on rate in the market for beer if one considers that whereas supermarkets tend to apply a pass-on lower than 100%,<sup>440</sup> on-trade sellers may apply a greater pass-on rate.<sup>441</sup>

Table 75 summarises the main impacts stemming from the increase of the threshold for low-strength beer to 3.5% vol. The total foregone tax revenues (including both excise duty and VAT paid on excise duty) are expected to amount to less than 1% of the total tax revenue from consumption of beer in the selected MS. Foregone tax revenues might be even lower, if one considers that the new market for low-strength beer could partially flourish on top rather than at the expenses of the market for standard beer. The reduction in taxation would lead to a price reduction for new low-strength beer (compared to standard beer) in the area of 2% to 6% in Belgium, Finland, Italy and Romania, where excise duty on beer are relatively low. The change in price would be around -12% in Finland and -11% in the UK, where standard rates are relatively high and substantially larger than reduced rates. Nonetheless, by assuming a price elasticity of demand (PED) of -0.54 (this is the average PED of a 2014 British HMRC study),<sup>442</sup> the change in *per capita* consumption of low-strength beer appears to be quite limited (from 0.02L to 0.10L per year).

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<sup>439</sup> For further details see the Section of this Study on measuring the Plato degree of sweetened/flavoured beer; European Commission 'EU rules for the taxation of alcohol', 2016; and London Economics (2010).

<sup>440</sup> A UK study found that supermarkets often avoid passing on excise duty to consumers, especially for cheaper products. This has been confirmed by both Italian and UK brewers interviewed for this Study. For further details, see Ally et al., 'Alcohol tax pass-through across the product and price range: do retailers treat cheap alcohol differently?', 2014, at [http://eprints.whiterose.ac.uk/87746/7/WRRO\\_87746.pdf](http://eprints.whiterose.ac.uk/87746/7/WRRO_87746.pdf) (last accessed on 10 July 2017).

<sup>441</sup> For further details, see BBPA (2010).

<sup>442</sup> For further details, see Sousa, 'Estimation of price elasticities of demand for alcohol in the United Kingdom', 2014 at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/387513/HMRC\\_WorkingPaper\\_16\\_Alcohol\\_elasticities\\_final.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/387513/HMRC_WorkingPaper_16_Alcohol_elasticities_final.pdf) (last accessed on 10 July 2017).

**Table 75 – Reduced rates for low-strength beer not exceeding 3.5% vol – impact analysis**

	BE	FI	IT	PL	RO	UK
Current market covered by reduced rates (hl)	-	61,910	-	-	-	244,973
New market covered by reduced rates (hl)	255,474	123,820	419,958	1,359,864	576,942	489,946
Average foregone tax revenues linked to reduced rates (EUR)	1,465,441	4,431,072	4,672,621	7,972,186	1,548,196	10,671,024
Average foregone tax revenues linked to reduced rates as a share of total tax revenues from consumption of beer (%)	0.51%	0.58%	0.59%	0.64%	0.70%	0.20%
Change in price linked to reduced rates (%)	-2.30%	-12.43%	-4.63%	-5.54%	-2.58%	-10.71%
Increase in <i>per capita</i> consumption linked to reduced rates (litre)	0.03	0.08	0.02	0.10	0.04	0.02

**Source:** Author's elaboration of Excise Duty Tables (2015), based on IWSR and on Panimoliitto (for consumption of low-strength beer in Finland), and on BBPA's elaboration of HMRC data for consumption of low-strength beer in the UK.

**Note:** Baseline year: 2015.

#### ➤ IMPACT ON PUBLIC HEALTH

Considering the above analysis of market effects, and more specifically the limited increase in *per capita* consumption of low-strength beer (from 0.02L to 0.10 L per year), any public health impact, either positive (in case the additional consumption of low-alcohol beer is 'at the expense' of standard beer and other stronger alcoholic beverages) or negative (in case low-strength beer substitutes soft drinks and facilitates the drinking initiation of young people), is negligible. This is particularly true if one considers that the overall per capita consumption of beer in the sample MS ranges from 31 litres in Italy to about 70 litres in Belgium, Finland and the UK, to 80 litres in Romania and 90 litres in Poland. These findings are aligned with stakeholders' feedback: several economic operators argued that the current segment below 2.8% is so narrow that any change in consumption due to a slightly increase in the threshold would have no noticeable impact on per capita alcohol consumption.

#### ➤ PUBLIC VIEW ON PROPOSED POLICY OPTIONS

Results from the OPC conducted on this topic provide a mixed picture. While 47% of participants who responded to this question welcome an increase in the threshold of low-strength beer from 2.8% to 3.5% vol, 44% of participants either partly or strongly disagree with this policy option (Figure 29). Most respondents who support the raise in the threshold for low-strength beer are beer producers (few brewers are against this policy option), while most respondents against it are producers of other alcoholic beverages (wine, OFP, intermediate products, and ethyl alcohol).

**Figure 29 – Public views on a possible increase of the reduced rates threshold for low-strength beer from 2.8% vol to 3.5% vol**



Source: OPC.

Note: 'Don't know' answers are not displayed.

### 3.4.2 Revised thresholds for wine, intermediate products and ethyl alcohol (option 2)

#### 3.4.2.1 Definition of the policy option

In the same way as for beer, improving the relevance of the thresholds for low-strength wine, intermediate products and ethyl alcohol and fostering production/consumption of such products require a revision of Articles 9(2), 18(3) and 22(5) of the Directive with the aim to raise the thresholds to apply reduced excise duty rates. This policy option is expected to generate impacts similar to those registered in the market for low-strength beer. First, tax revenues would be affected, as larger volumes of alcoholic beverages could benefit from reduced rates. Second, market effects would be registered, as lower taxation would most likely lead to lower price (depending on the extent to which the discount is passed on to consumers) and increased consumption. Revised thresholds may also provide incentives to develop and commercialise new low-alcohol beverages. Finally, some public health impacts might stem from a greater consumption of low-strength alcoholic beverages. Option 2 would need to be further detailed as, at this stage, there is no agreement among stakeholders or in the literature on possible alternative thresholds. Therefore, in what follows, the impacts generated by this option are assessed in a qualitative fashion.

**Table 76 – Overview of impact areas of the proposed policy option on revising the low-strength threshold of other products**

Policy option	Impact areas	Nature of impact expected
<b>Increased thresholds to apply reduced rates to low-strength wine, intermediate products and spirits</b>	<ul style="list-style-type: none"> <li>• Tax revenues (MS applying reduced rates)</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in tax revenues from consumption of wine, intermediate products and ethyl alcohol</li> </ul>
	<ul style="list-style-type: none"> <li>• Market effects (Producers of low-strength wine, intermediate products or ethyl alcohol)</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in price and increase in consumption of low-strength wine, intermediate products and ethyl alcohol</li> <li>• New market opportunities/production innovation stemming from revised thresholds</li> </ul>
	<ul style="list-style-type: none"> <li>• Public health</li> </ul>	<ul style="list-style-type: none"> <li>• Change in consumption of low-strength wine, intermediate products and ethyl alcohol may generate ambivalent public health impacts</li> </ul>

### 3.4.2.2 Impact analysis

#### ➤ **IMPACT ON TAX REVENUES AND MARKET EFFECTS**

As for wine, independent experts as well as stakeholders from several MS have emphasised that the bulk of the market is above 10% vol. Below this threshold, besides special wine and products based on wine (which tend to be even below 8.5% vol), there are mostly sweet wine (containing unfermented sugar) and some wine processed to reduce alcohol content. Interviewees also claimed that the potential to develop low-alcohol products is rather limited in the wine market: i) the minimum alcohol strength is defined by Union law and international regulation; ii) wine is a product whose alcohol strength is determined by a number of natural production variables such as grape variety, climate, altitude and proximity to water; iii) the alcohol strength contributes to the specific taste of certain types of wine. Therefore, any change in the threshold (now at 8.5% vol) would provide only little incentive to produce/consume low-alcohol wine and would still leave most of the 'traditional' wine outside the scope of the provision, with limited impacts in terms of tax revenues and changes in consumption. The magnitude of tax and market effects of reduced rates for low-strength wine is further limited by the fact that wine already benefits from a zero rate in several MS.

EU rules also set the minimum alcohol content for wine fortified for distillation (18-24% vol). Therefore, an increase in the threshold for low-strength intermediate products (now at 15% vol) may allow applying reduced rates to some 'traditional' intermediate products. Statistics on consumption of these products by alcohol content are not available; therefore, it is not possible to quantify the share of the market that would benefit from an increase in the threshold on low-strength intermediate products. Nonetheless, it is worth noticing that in many instances traditional products have also access to the reduced rates established under Article 18(4) of the Directive, so the concrete effects would be limited.

When it comes to ethyl alcohol, as discussed above, according to Union law, spirits have minimum alcohol strength of 15% vol; therefore, even a substantial increase of the threshold from 10% vol (current threshold) to 15% vol would have no impact on tax revenues, production and consumption of 'traditional' spirits. By contrast, an increase in the threshold would have an impact on the market for mixed drinks (i.e. long drinks, pre-mixed cocktails and FAB) and other special 'products'. As discussed above, while some mixed drinks are still above 10% vol, a sizeable portion of such market is below 15% vol and would benefit from an increase in the threshold. In this context, it is worth stressing that FAB, which in 2015 represented about 6% of the EU market for ethyl alcohol (in volume), are generally below 10% vol. Therefore, an increase in the threshold would mainly affect long drinks and pre-mixed cocktails. If one considers that a portion of the market for long drinks and pre-mixed cocktails is already below 10% vol and that in 2015 these products overall represented only 2.7% of the total EU market for ethyl alcohol, it is apparent that any increase in threshold would have limited tax and market effects. In addition, it is important to bear in mind that only Finland currently applies reduced rates to low-strength ethyl alcohol (below 2.8% vol) and any change in the threshold would not necessarily lead to a broader uptake of this provision by MS.

#### ➤ **IMPACT ON PUBLIC HEALTH**

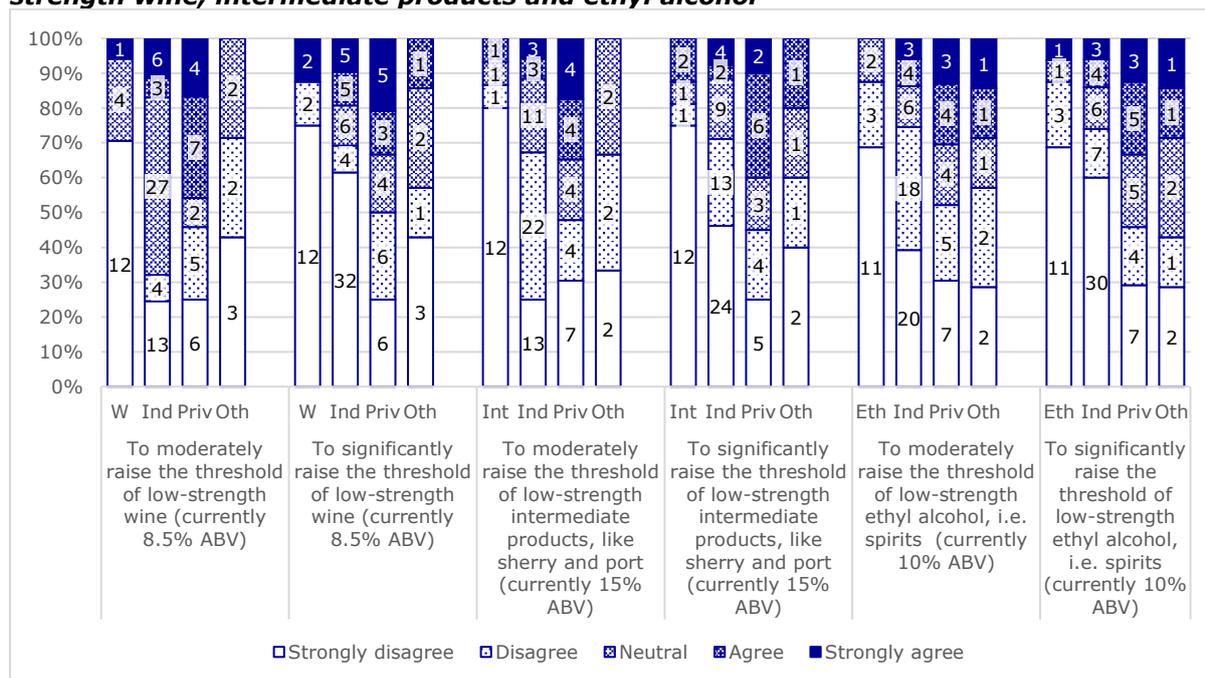
As discussed above, the impact of reduced rates for low-strength alcohol on per capita consumption – hence public health – may be ambivalent. On the one hand, tax reductions may favour substitution between standard alcoholic beverages and low-strength alcoholic beverages, thus reducing alcohol intake by consumers. On the other hand, they may favour substitution between soft drinks and alcoholic beverages, incentivise consumers to drink larger quantities of alcoholic beverages and facilitate the drinking initiation of young people.

As mentioned, an increase of the thresholds for wine, intermediate products and ethyl alcohol is expected to have minor market effects when it comes to 'traditional' products. By contrast, it may affect the market for certain aromatised wine-based drinks as well as certain mixed drinks, which are relatively more appealing than traditional products to younger cohorts of consumers (according to various interviewees). Therefore, applying reduced rates on such products may eventually encourage consumption of alcohol among young people with negative impact on public health targets.

➤ **PUBLIC VIEW ON PROPOSED POLICY OPTIONS**

The results from the OPC indicate a very limited support by the industry stakeholders to the revision of the current thresholds for wine, intermediate products and ethyl alcohol. With regard to wine, over 70% of stakeholders representing the wine industry are strongly against any change, be it moderate or significant. Results for intermediate products are similar, with most of industry stakeholders against revising the threshold to apply reduced rates. Finally, when it comes to ethyl alcohol, almost 90% of stakeholders representing the ethyl alcohol industry are against either a moderate or substantial change in the threshold. Opinions expressed by private individuals were somewhat more varied across all questions, with relatively higher shares of respondents expressing agreement towards an increase of the thresholds.

**Figure 30 – Public views on a possible increase of the reduced rates threshold for low-strength wine, intermediate products and ethyl alcohol**



Source: OPC.

Legend: W: industry stakeholders with an interest in the wine sector; Int: industry stakeholders with an interest in the intermediate products sector; Eth: industry stakeholders with an interest in the ethyl alcohol sector; Ind: rest of the industry (not included in the previous category); Priv: private individuals; Oth: Other (public health NGOs, public authorities, etc.).

Note: industry stakeholders with an interest in the production or end-use of industrial alcohol have been included in the 'Ind' category whenever present. If not present, they have been included in the residual 'Oth' category.

'Don't know' answers are not displayed.

### 3.5 Exemptions for private production

#### 3.5.1 Definition of policy options

The problem definition presented in Section 2.5.2 shows that in most MS the home production of distilled products is treated differently than fermented beverages. While home production of beer, wine, and other fermented beverages is legal and duty free, in 4 out of the 6 sample MS private distillation is prohibited. The Council has thus invited the Commission to consider the possibility to redress this unequal treatment. This objective can be achieved by means of a **legislative revision**: extending the exemption for private production to intermediate products and ethyl alcohol.

Specifically, it is assumed that the legislative revision would introduce exemptions for ethyl alcohol and intermediate products, which will be drafted along the lines of those currently included in Articles 6, 10, and 14:

*Subject to such conditions as they shall lay down to ensure the straightforward application of the exemption, Member States may exempt from excise duty [intermediate products / ethyl alcohol] produced by a private individual and consumed by the producer, members of his family or his guests, provided that no sale is involved.*

As a consequence:

- the exemption remains optional for the MS;
- in the MS where this option is applied, not only private distillation becomes duty free, but, most importantly, it becomes legal; conversely, MS retain the possibility to prohibit home distillation if they do not implement the option;
- MS may stipulate the conditions that they consider appropriate to the management of the exemption, e.g. registration obligations, reporting duties, quantitative allowance, definition of the conditions at which 'no sale is involved'.

During the Inception Phase, it was suggested not to further consider the possibility to provide non-binding guidelines concerning the exemption for private production. Based on the findings described in Section 2.5.2, this is confirmed as appropriate, because:

- No regulatory or market failure has been identified as regards the products for which the Directive already provides an exemption; public authorities, health organisations and economic operators expressed no concerns in this respect;
- The uneven treatment of different alcoholic beverages can be solved only via an amendment to the Directive, as the exemption is not currently foreseen in the current text and could not be introduced via non-legislative interventions.

**Table 77 – Overview of impact areas of the proposed policy option on extending private production exemptions to other products**

Regulatory Option	Impact areas	Nature of Impact Expected
<b>Extension of the exemption for private production to intermediate products and ethyl alcohol</b>	<ul style="list-style-type: none"> <li>• Tax revenues for public authorities</li> </ul>	<ul style="list-style-type: none"> <li>• If duty exemption led to a substitution of taxed products with home production, tax revenues could decline.</li> </ul>
	<ul style="list-style-type: none"> <li>• Market effects for economic operators (including cross-border)</li> </ul>	<ul style="list-style-type: none"> <li>• If duty exemption led to a substitution of taxed products with home production, economic operators will be negatively impacted.</li> </ul>
	<ul style="list-style-type: none"> <li>• Health impacts for consumers</li> </ul>	<ul style="list-style-type: none"> <li>• Allowing private distillation is likely to result in higher alcohol consumption and risks of methanol intoxication.</li> </ul>

Regulatory Option	Impact areas	Nature of Impact Expected
	<ul style="list-style-type: none"> <li>Enforcement costs for public authorities</li> </ul>	<ul style="list-style-type: none"> <li>Additional enforcement resources should be spent in controlling compliance with the new regime.</li> </ul>
	<ul style="list-style-type: none"> <li>Administrative burdens for private distillers</li> </ul>	<ul style="list-style-type: none"> <li>Reduction of administrative burdens is expected to be largely theoretical given current level of non-compliance; possible increase in case regulatory systems are put up at national level.</li> </ul>

### 3.5.2 Impact Analysis

In this Section, the impacts of the extension of the exemption for private production are discussed. First, the expected change to the amount of private distillation is estimated in quantitative terms. Then, based on the magnitude of this change, the other relevant impacts are quantified, where possible – e.g. in the case of market effects and tax revenues – or discussed in qualitative terms – e.g. in the case of health impacts. A comparison of the policy option with the *status quo* is provided in Section 4.5.1 below.

In line with the current wording of the Directive, the exemption for private production of intermediate products and ethyl alcohol would remain optional. Its impacts thus depend on both the amendments to the Directive, as well as on the MS' choice to implement such an option. The analysis is carried out under the assumption that the sample MS would apply the exemptions. Such an assumption will be discussed in the sub-section on stakeholders' view, further below.

#### 3.5.2.1 Impact on private distillation

Extending the exemption for private production for own consumption to private distillation would have both a static and a dynamic effect:

- The activity carried out by private distillers would become legal; it can be assumed that all current home distillers will carry on their activity under the exemption.
- New private distillers may become active, or existing private distillers may increase their production.

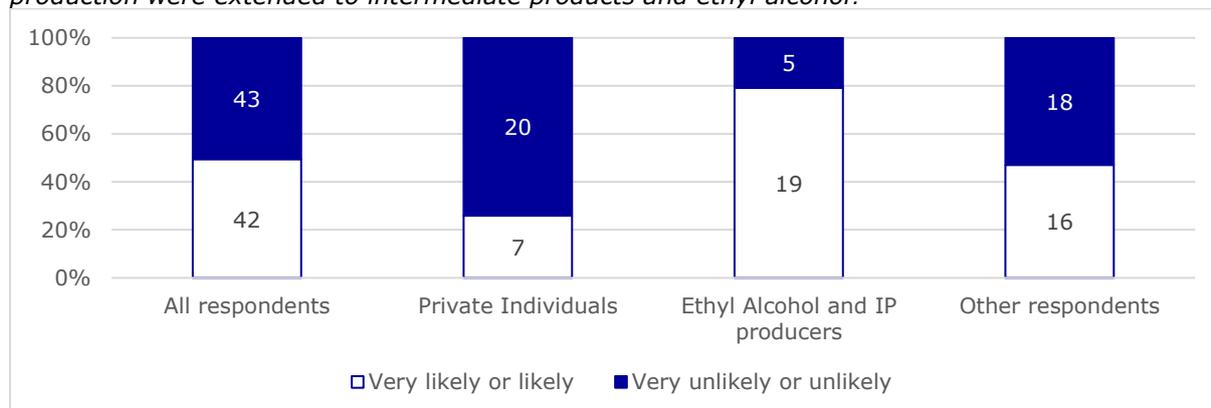
A quantitative assessment of the magnitude of this dynamic effect is therefore needed to estimate the changes in the amount of private distillation under the new regime.

Economic operators and public authorities were surveyed during targeted interviews to understand whether and to what extent private distillation would increase as a result of this policy option. Many of them were not in a position to provide an estimate, but those who provided an assessment agreed that an exemption would generate an increase in private distillation in the countries where this is currently prohibited. In Austria, such an exemption would cover also citizens other than farmers. Only in Romania, where private production is more widespread – both licit and taxed at a reduced rate, and illicit – stakeholders suggested that an exemption would not result in an increase of its already high levels of private distillation.

To estimate the magnitude of the dynamic effect, data from the OPC are resorted to. In Question 37, stakeholders were asked to estimate the likelihood of an increase in private distillation should this policy option be adopted. Figure 31 below provides the answers across various groups.

**Figure 31 – OPC results for Question #37.2**

In your opinion, would an increase in private distillation occur if the exemption for private production were extended to intermediate products and ethyl alcohol?



**Source:** OPC.

**Note:** 'Don't know' answers are not displayed.

The respondents to the OPC had split views on the likelihood of an increase in private distillation. In particular, 26% of private individuals<sup>443</sup> – those directly affected by the exemption – considered an increase as 'likely' or 'very likely', and 79% of producers of ethyl alcohol and intermediate products did so.<sup>444</sup> Private individuals' view is considered indicative of the extent to which home distillation would increase.<sup>445</sup> Hence, it is assumed that, due to the appearance of new private distillers or to an increased production of current private distillers, home production of distilled products would increase by 26% in the countries covered by the analysis, except for Romania, where it is estimated that such a policy change would unlikely alter a situation in which private distillation is already widespread. The increase in private distillation under this assumption for the 6 sample MS is reported in Table 78. Extrapolation at EU level is done considering the share of unrecorded alcohol in the 6 MS over EU total (40%, based on WHO GISAH data).

**Table 78 – Impact of a possible exemption on the volume of private distillation**

	Illicit private distillation (baseline)	Private distillation after the exemption	Difference
	hlpa		
Austria	1,103	1,389	287
Finland	1,052	1,326	274
Italy	13,103	16,510	3,407
Poland	38,749	48,824	10,075
Romania	25,119	25,119	-
United Kingdom	6,409	8,076	1,666
<b>Total</b>	<b>85,535</b>	<b>101,244</b>	<b>15,708</b>
<b>EU</b>	<b>212,264</b>	<b>251,245</b>	<b>38,982</b>

**Source:** Author's analysis on WHO, IWSR, findings from the interviews and desk research.

### 3.5.2.2 Market Effects and Impacts on Tax Revenues

<sup>443</sup> Out of 27 private individuals responding to this question.

<sup>444</sup> Out of 24 entities active in the intermediate product or ethyl alcohol sectors responding to this question.

<sup>445</sup> Other quantitative parameters could not be identified during fieldwork and desk research, and the stakeholders interviewed could not suggest possible ranges. Indeed, laws on distillation and home distillation are considered very stable, the legal allowances and exceptions date back to a long time ago (e.g. they were introduced in 1830 in Austria), and the underlying social norms prove constant. In particular, no recent introduction of an exception or the removal of a prohibition could be identified, which could serve as a guidance to verify the magnitude of this effect.

An increase in private distillation could be neutral in terms of market effects if all additional home-made beverages would correspond to additional alcohol consumption. However, it is foreseeable that these new beverages would in part substitute existing products on the market, and in part result in new consumption. To make this clear, it implies that new private distillers would enter the activity<sup>446</sup> and would produce home-distilled products. These new private distillers are assumed to no longer buy commercial products (or no longer the same quantity thereof), hence substituting existing consumption; at the same time, it is also likely that they will increase their overall consumption of distilled products.

To estimate the share of substitution, OPC data can again be resorted to. While 26% of private individuals expect an increase in home distillation, a lower share of them, 18% expect an increase in alcohol consumption. The ratio between these two shares (69%) is used as a parameter to estimate how much additional private distillation would result in additional consumption. Conversely, 31% of the new private distillation estimated above is assumed to substitute existing consumption on the spirit market. In all countries – except for Romania, where changes to private distillation are assessed to be nihil – a contraction of the market for spirits is estimated, but the magnitude of this impact is low, between less than 0.1% and 0.3%. Extrapolating results at EU level, based on the share of unrecorded alcohol consumption in the sample MS, the reduction of the spirit market is estimated at 0.1% of the current volumes. Results are shown in Table 79. Given such a low magnitude and the local circulation of home-made products, no cross-border impacts are expected.

**Table 79 – Expected impacts of exemptions for private production on the market of spirits**

	Expected reduction in the market of spirits		
	In hlpa	In hl	As a % of current market
Austria	89	222	0.1%
Finland	85	212	0.1%
Italy	1,056	2,640	0.2%
Poland	3,123	7,808	0.3%
Romania	-	-	0.0%
United Kingdom	517	1,291	0.0%
<b>Total</b>	<b>4,870</b>	<b>12,174</b>	<b>0.1%</b>
<b>EU</b>	<b>12,084</b>	<b>30,211</b>	<b>0.1%</b>

**Source:** Author's analysis on WHO, IWSR, findings from the interviews and desk research.

Impacts on tax revenues are threefold:

- (i) The fact that previously illicit private distillation becomes licit is neutral from a tax perspective – no tax was collected before, and no tax is collected afterwards; in other words, the option does not lead to the recovery of existing foregone revenues.
- (ii) New private distillation is tax neutral when it translates into additional alcohol consumption, while it leads to a reduction of excise revenues when it substitutes current market consumption; the impacts on excise revenues are reported in Table 80 below. As in the case of market effects, the magnitude of these impacts remain very limited, at about EUR 18 mn, or 0.3% of current revenues from ethyl alcohol. Only in Poland a loss of excises larger than EUR 10 mn is estimated. At EU level, reduction in excise revenues can be estimated at about EUR 45 mn, based on the share of unrecorded alcohol consumed in the sample MS.

<sup>446</sup> Or that previously illicit private distillers would increase their production.

- (iii) In Romania, where private distillation is allowed and a reduced excise rate imposed, the extension of the exemption, if implemented, would reduce excise revenues therein.<sup>447</sup>

**Table 80 – Expected impacts of exemptions for private production on excise duty revenues**

	Reduction in excise duty revenues	
	In '000 €	In % of current revenue
Austria	144	-0.1%
Finland	966	-0.2%
Italy	2,734	-0.4%
Poland	10,373	-0.6%
Romania	-	0.0%
United Kingdom	4,091	-0.1%
<b>Total</b>	<b>18,308</b>	<b>-0.3%</b>
<b>EU</b>	<b>45,434</b>	<b>-0.3%</b>

**Source:** Author's analysis on WHO, IWSR, findings from the interviews and desk research.

With respect to the risk of tax frauds, they are expected to remain negligible.<sup>448</sup> Economic operators consider that private distillers remain unlikely to supply the informal or illicit markets with sufficient quantities and of sufficient quality to represent a competitive threat. While customs authorities remain concerned with tax frauds, they do not judge the additional risk as substantial. In some cases private distillation is associated with limited sales in local markets – which however customs authorities and economic operators do not perceive as a significant threat – and this risk would increase in line with the estimated growth in home-distilled products. Their main concern, especially in countries where the market for illicit alcohol is relevant, is with surrogate beverages obtained from denatured alcohol, and with clandestine distillation.<sup>449</sup> Economic operators confirmed that indeed the costs for surrogate alcohol and clandestine distillation are much lower compared to private distillation, and that these 'business models' remain more profitable for criminal activities.

With respect to cross-border effects, as discussed in the problem definition, the circulation of home-distilled products is very local, and no cross-border spill over was identified or reported. The modest increase in home distillation expected from this policy option is not expected to alter this situation, and cross-border negative effects are thus estimated to be minimal.

### 3.5.2.3 Public health impacts

As described in Section 2.5.2 above, with respect to per capita alcohol consumption, the primary harm from unrecorded alcohol, including home production, arises from the fact that it is typically much more available and accessible than recorded alcohol, thus leading to higher health risks.

Furthermore, privately-distilled beverages result in higher health risks due to methanol intoxication; at the same time, health authorities reported that most of the cases of

<sup>447</sup> No data or estimate could be retrieved on the amount of private distillation that is currently taxed, hence this assessment remains only qualitative. One Romanian stakeholder suggested that it would be unlikely that those who privately produce spirits paid the reduced excise duties, given that the likelihood of being caught by controls is very low. However, such an assumption could not be verified.

<sup>448</sup> 55% of the respondents to the OPC expressed that an increase in the risk of tax frauds is likely or very likely (with no judgment on the magnitude of such an increase). During fieldwork interviews, operators and public authorities expressed limited concerns with the magnitude of this incremental risk.

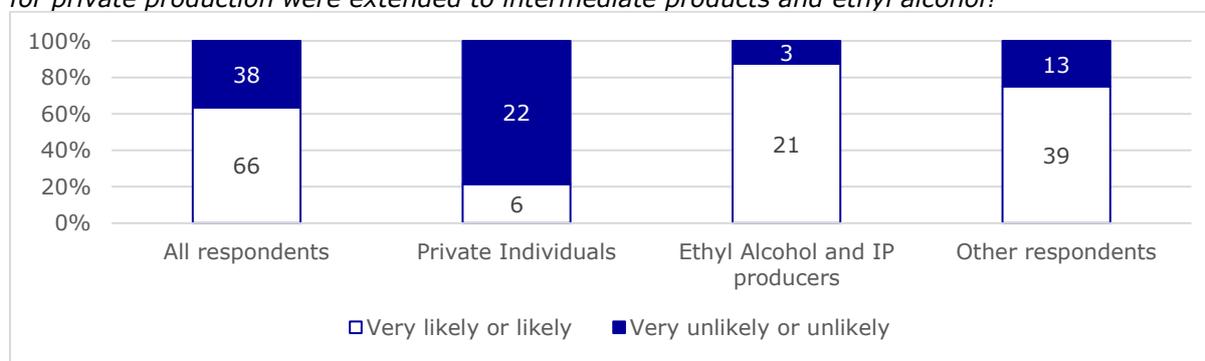
<sup>449</sup> Though clandestine distillation could, in principle, be disguised as home distillation, the former requires possession of much larger-scale equipment, which could hardly be justified for the consumption of products 'for own use'.

methanol intoxication are linked to surrogate alcohol or adulterated products, and that limited methanol-related negative effects can be traced back to home-distilled products. The exemption would result in an increase of private distillation and, thus, to a corresponding higher risk of adverse events. This was confirmed by the bulk of the stakeholders interviewed during the fieldwork, including public authorities, economic operators and health institutions, both in countries where private distillation is common, as well as in countries where it is not. In particular, since this policy option would attract new private distillers, these may have a lower expertise in handling the methanol removal process and would thus be at a higher risk of intoxication.

In the OPC, respondents were asked to estimate to what extent an extension of the exemption would result in increased health risks. Most of respondents considered it to be likely or very likely, with only private individuals deeming that higher health risks were not probable.

### Figure 32 – OPC results for Question #37.5

*In your opinion, would private distillation increase the health risks for consumers if the exemption for private production were extended to intermediate products and ethyl alcohol?*



**Source:** OPC.

**Note:** 'Don't know' answers are not displayed.

#### 3.5.2.4 Other impacts

Under the current regime, limited enforcement resources are spent by customs authorities to monitor private distillation. Should private distillation be allowed, it is likely that some MS would introduce some light form of regulation (e.g. registration of distillers / distillation equipment and notification of the quantities distilled), as it is already the case where private distillation is legal, such as in Austria and Romania. These light forms of regulation would require deployment of additional enforcement resources.

Private distillers currently do not bear, in practice, any administrative burden. Indeed, the regime applicable to licensed distillers is so burdensome that hardly any private distiller complies with the applicable regulatory framework. As a consequence, the extension of the exemption for private production to intermediate products and ethyl alcohol would not cause any savings in administrative burdens. The only country in which private individuals bear an amount of administrative burdens when doing home distillation is Romania, and those burdens could be saved if private distillation became duty-free and the registration duties were scrapped. On the contrary, additional burdens could arise for private distillers if the exemption is extended, depending on the regulatory regime set up at national level for monitoring purposes.

#### 3.5.2.5 Stakeholders' view

Even though the exemption for private production of intermediate products and ethyl alcohol were introduced in the Directive, the occurrence of the effects described above

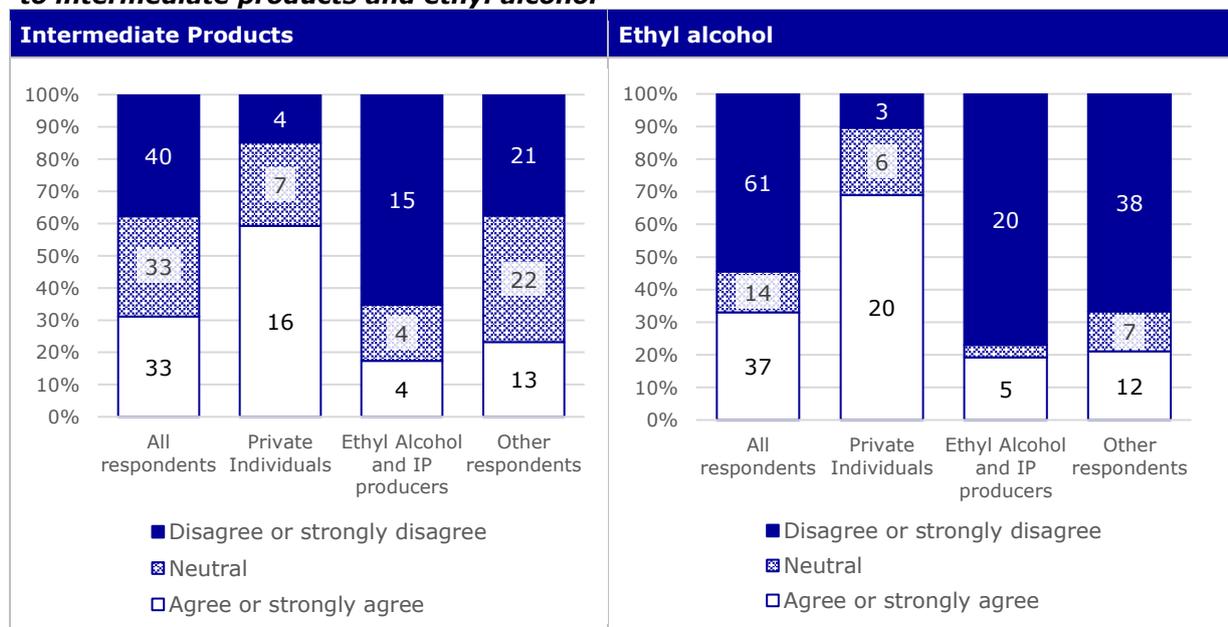
would depend on the choice of each MS. In MS which decided not to implement the exemption, no increase of private distillation is likely, and hence there would be no further impact.

According to the targeted interviews carried out during the fieldwork, tax and customs authorities expressed a mild to severe disagreement with the option. The main reasons mentioned against this possibility include: (i) risks of adverse health impacts, because of methanol intoxication; (ii) higher risk of tax frauds as private distillation is so dispersed as to become difficult to police and regulate; and (iii) the possibly negative symbolic effects linked to the liberalisation of distillation activities, which could result in an increase of spirit consumption. These findings are in line with those reported in the Ramboll Evaluation, where 17 MS opposed to the exemption, whilst only 8 were in favour.<sup>450</sup>

Based on the information described above, the likelihood of the implementation of the exception for the private production of intermediate products and ethyl alcohol is low, and the take up of this provision would be limited to a minority of MS. Only in these MS impacts such as those estimated in this Section would arise. Given the minimal cross-border spill overs expected, the decision of each MS would largely remain independent from the choice of the other and could reflect its own national preferences, traditions and culture.

In the OPC, stakeholders were asked to provide their view on the extension of the exemption for private production to intermediate products and ethyl alcohol. As shown in Figure 33 below, considering all respondents, a plurality was against the extension to intermediate products (38%) and a majority to ethyl alcohol (54%). The number of respondents in favour of the extension was, for both categories, slightly less than one third of the total. Views remained quite split: private individuals were largely in favour of extending the exemption to both products, while manufacturers of ethyl alcohol and intermediate products were largely against it.

**Figure 33 – Public views on a possible extension of the exemption for private production to intermediate products and ethyl alcohol**



Source: OPC.

<sup>450</sup> See Ramboll Evaluation, p. 74.

### 3.6 Measurement of Plato degree for sweetened/flavoured beer

#### 3.6.1 Definition of policy options

The policy problem linked to the different existing methods to measure the Plato degree of sweetened/flavoured beer, can be addressed either amending the Directive or through non-regulatory measures. In particular (see Table 81):

- **Option 1.** The regulatory option consists of an amendment of Article 3(1) to clarify what constitutes a 'finished product' when it comes to sweetened/flavoured beer. More specifically, the following approaches are possible:
  - Under **option 1.A**, the term 'finished product' would refer to the base beer before adding any additive. This is the approach A described in Section 2.6.1.4.
  - Under **option 1.B**, the term 'finished product' would refer to the end-product that is released for consumption. Such option can be further subdivided into the two approaches B1 and B2, described in Section 2.6.1.4, depending on whether the sugar/flavour added after fermentation would contribute (**option 1.B.2**) or not (**option 1.B.1**) to the Plato degree of the end-product.
- **Option 2.** The non-regulatory option consists of providing guidance on the most appropriate approach to measure the Plato degree of sweetened/flavoured beer via non-binding guidelines of the Commission. In fact, this option can be either alternative or complementary to option 1, in the sense that guidelines could also support the implementation of the revised regulatory provision, suggesting technical solutions, procedures and other best practices to national authorities. Also option 2 would allow for three main sub-options, corresponding to the three main approaches to Plato degree measurement reviewed in this Study:
  - **option 2.A** - approach A (the 'base beer' approach);
  - **option 2.B.1** - approach B1 (the 'real extract' approach);
  - **option 2.B.2** - approach B2 (the 'present extract' approach).

**Table 81 – Structure of the proposed policy options on the measurement of Plato degree for sweetened / flavoured beer**

Options	Type of option		Selected measurement approach		
	Regulatory	Non-regulatory	A	B1	B2
<b>Option 1.A</b>	X		X		
<b>Option 1.B.1</b>	X			X	
<b>Option 1.B.2</b>	X				X
<b>Option 2.A</b>		X	X		
<b>Option 2.B.1</b>		X		X	
<b>Option 2.B.2</b>		X			X

All options sub-options revolve around the selection of one of the three existing approaches and, therefore, they would have the same 'type' (but not 'magnitude') of impact. As summarised in Table 82 all 'change' options would affect excise duty payable on sweetened/flavoured beer and the ensuing tax revenues in MS that currently follow a different approach. A change in the excise duty applied might have an impact on the retail price of end-products, in turn, on the demand, with possible consequences on per public health targets as well as on competition (as seen certain approaches may result in

sweetened/flavoured beer taxed more heavily than standard beer with the same alcohol content).<sup>451</sup>

Different measurement approaches entail different procedures for checking the Plato degree of sweetened/flavoured beer released for consumption, with different enforcement costs for the responsible authorities. Finally, the adoption of a harmonised approach at the EU level may increase legal certainty and reduce the costs and burdens of disputes between tax authorities and producers.

**Table 82 – Overview of impact areas of the proposed policy options on the measurement of Plato degree for sweetened / flavoured beer**

Options	Impact areas	Nature of Impact Expected
<b>Selection and clarification of the most appropriate approach to measure the Plato degree of sweetened / flavoured beer</b> (all options and sub-options)	<ul style="list-style-type: none"> <li>• Tax revenues (for MS applying the Plato method)</li> </ul>	<ul style="list-style-type: none"> <li>• Change in excise duty applied to sweetened/flavoured beer</li> </ul>
	<ul style="list-style-type: none"> <li>• Market effects (for brewers of sweetened/flavoured beer)</li> </ul>	<ul style="list-style-type: none"> <li>• Change in (price and) consumption of sweetened/flavoured beer</li> </ul>
	<ul style="list-style-type: none"> <li>• Public health</li> </ul>	<ul style="list-style-type: none"> <li>• In the event of substitution effects, resulting in a variation of per capita consumption (especially among young persons)</li> </ul>
	<ul style="list-style-type: none"> <li>• Enforcement costs (for MS applying the Plato method)</li> </ul>	<ul style="list-style-type: none"> <li>• Any change between approaches requires new procedures for checking the Plato degree of sweetened/flavoured beer placed on the market</li> </ul>
	<ul style="list-style-type: none"> <li>• Unfair competition (for brewers of sweetened/flavoured beer)</li> </ul>	<ul style="list-style-type: none"> <li>• Some measurement approaches may result in disparities of Plato degree between standard and sweetened/flavoured beer with the same alcohol content.</li> </ul>
	<ul style="list-style-type: none"> <li>• Litigation costs</li> </ul>	<ul style="list-style-type: none"> <li>• Selecting the measurement approach at the EU level would increase legal certainty and reduce conflicts between tax authorities and brewers</li> </ul>

The impact analysis developed in the next Section is primarily centred on the effects of selecting one of the three methods, somehow irrespective of the regulatory or non-regulatory option chose (i.e. amending Article 3(1) or providing non-binding guidance). Nonetheless, regulatory and non-regulatory options may be different when it comes to the implementation, so a specific Section on the likely ‘effectiveness’ of the two options have been added.

Furthermore, it is worth remarking that the awaited judgement of the CJEU on the Polish case (Box 21) may contribute to address – and eventually clarify - the policy problems. In this respect, the impact analysis is not intended to support any of the existing interpretations, but aims at providing objective, factual evidence on the possible effects that would materialise under the different scenarios.

### 3.6.2 Impact analysis

#### 3.6.2.1 Methodology

In our analysis we focus on the effects in the six sample MS considered, which, as seen, represent the large majority of the sweetened/flavoured beer market in the EU countries that have adopted the ‘Plato’ method. Depending on which measurement approach is selected, a different number of MS would have to switch from their current approach to the selected one. More specifically, if approach B2 were selected, only 1-2 MS would

<sup>451</sup> This chain of effects holds on the assumption that any change in excise duty is (either fully or partially) passed on to consumers.

have to adapt: Romania (currently using approach A), and Italy, that is however reportedly 'in transition'. If approach B1 were selected, all sample MS would have to move away from their current approach (including Italy, that according to some stakeholders is potentially already oriented to it). If approach A were selected, only Romania may maintain its current approach, whereas all others would need to adapt.

The impact analysis was carried out as follows. For each of the six MS we estimated the effect of changing the measurement approach on the applicable excise duty, and the consequences on price, consumption, and tax revenues.

- First, the change in excise duty per hectolitre was calculated as the relevant excise duty rate multiplied by the difference in Plato degree from the baseline approach to the approach analysed. As shown previously (see Table 49), the change in excise duty differs for radler and other flavoured beer, based on the typical Plato degree per product. This reflects the fact that for radler the difference in Plato degree is greatest for different measurement approaches.
- Second, bearing in mind that VAT is computed also on excise duty, the change in price was estimated as the sum of the change in excise duty and the ensuing changes in VAT.
- Then, the change in consumption volume was computed using the percentage price change and a price elasticity of demand (PED) of -0.54. This is the average (between off- and on-trade) PED of a 2014 British HMRC study.<sup>452</sup> It should be noted that the calculations were performed under the assumption that changes in the payable excise duty are 100% passed on to the consumer. In reality, this might not always be the case. On the one hand, large distribution for instance is often reluctant to increase beer prices following a rise in excise duty.<sup>453</sup> On the other hand, in the on-trade market an excise duty increase may lead to retail prices rising by greater than the duty increase itself.<sup>454</sup>
- Finally, based on the new consumption volume after the price change, the overall tax revenues (including VAT on excise duty) stemming from sweetened/flavoured beer were estimated.

Before analysing the estimated impacts, it is worth reiterating that the analysis applies to beer where sugar/flavour is added after fermentation and not before it (in which case the Plato degree is not affected by the measurement approach). Since the IWSR market data used for the analysis do not distinguish between these two types of product we have carried out the impact assessment on the entire market of sweetened/ flavoured beer, but results should be considered as the upper bound estimates.

### 3.6.2.2 Impacts on tax revenues and market effects

#### ➤ AUSTRIA

In the case of Austria the price of sweetened/flavoured beer would decrease by about 6% and consumption (volume) would increase by about 3% when switching from approach B2 (baseline and no change scenario) to approach A or B1. Tax revenues (excise duty and VAT on excise duty) generated by sweetened/flavoured beer would decrease considerably by about 43%. The changes are significant, as the Austrian sweetened/flavoured beer market consists entirely of radler. Nonetheless, when compared with total beer consumption and total tax revenue (excise duty and VAT on excise duty) on beer, the magnitude of changes becomes minor: consumption of beer

<sup>452</sup> For further details, see Sousa (2014).

<sup>453</sup> Ally et al. (2014).

<sup>454</sup> For further details, see BBPA (2010).

would increase by only 0.2%, tax revenues would decrease by about 2%, i.e. less than EUR 5 million out of more than EUR 226 million.

**Table 83 – Expected impacts of the proposed policy options on the measurement of Plato degree for sweetened/favoured beer in Austria**

Option	1.A / 2.A	1.B.1 / 2.B.1	1.B.2 / 2.B.2 (no change)
Approach	A	B1	B2 (Baseline)
<b>Average price of radler (EUR/hl)*</b>	172	172	183
% Change in price	-5.9%	-5.8%	no change
<b>Overall consumption of sweetened/flavoured beer (hl)</b>	492,260	491,826	476,952
% Change over sweetened/flavoured beer	3.2%	3.1%	no change
% Change over total beer	0.2%	0.2%	no change
<b>Tax revenues from sweetened/flavoured beer (EUR)**</b>	6,475,019	6,620,677	11,451,017
% Change over revenues from sweetened/flavoured beer	-43.5%	-42.2%	no change
% Change over revenues from total beer	-2.2%	-2.1%	no change

**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Baseline year: 2015; \*Based on IWSR the Austrian sweetened/flavoured beer market consists entirely of radler; \*\* Excise duty and VAT on excise duty.

#### ➤ BELGIUM

In Belgium, the changes are weaker, given that the market is dominated by sweetened/flavoured beer other than radler. Still, tax revenues (including VAT on excise duty) fall by roughly 22-23% when changing from approach B2 (baseline and no change scenario) to approach A or B1. Price would only decrease by about 4% for radler and 1.5% for other sweetened/flavoured beer; overall consumption of sweetened/flavoured beer would increase by some 1%. Again, such impacts appear to be marginal when compared to the overall beer consumption (+0.1%) and total tax revenues (including VAT on excise duty) on beer (-1.5%, i.e. EUR 3.5 million out of EUR 235 million).

**Table 84 – Expected impacts of the proposed policy options on the measurement of Plato degree for sweetened/favoured beer in Belgium**

Option	1.A / 2.A	1.B.1 / 2.B.1	1.B.2 / 2.B.2 (no change)
Approach	A	B1	B2 (Baseline)
<b>Average price of radler (EUR/hl)</b>	256	257	266
% Change in price	-3.8%	-3.7%	no change
<b>Average price of other sweetened/flavoured beer (EUR/hl)</b>	406	405	411
% Change in price	-1.4%	-1.6%	no change
<b>Overall consumption of sweetened/flavoured beer (hl)</b>	530,552	530,885	524,948
% Change over sweetened/flavoured beer	1.1%	1.1%	no change
% Change over total beer	0.1%	0.1%	no change
<b>Tax revenues from sweetened/flavoured beer (EUR)*</b>	12,341,679	12,075,829	15,795,902
% Change over revenues from sweetened/flavoured beer	-21.9%	-23.6%	no change
% Change over revenues from total beer	-1.5%	-1.6%	no change

**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Baseline year: 2015; \* Excise duty and VAT on excise duty.

## ➤ GERMANY

Germany has a low excise duty rate on beer (EUR 0.79/hl/° Plato in 2017). The price changes from approach B2 (baseline and no change scenario) to A/B1 are thus rather low (-2.2% for radler and about -1% for other sweetened/flavoured beer), and so are the resulting changes in overall consumption volume of sweetened/flavoured beer. Tax revenues (including VAT on excise duty) generated by sweetened/flavoured beer would change by roughly one third compared to the baseline approach. Still, the loss in tax revenue (about EUR 7 million) does not even amount to 1% of the total tax revenue from consumption of beer in Germany (more than EUR 805 million).

**Table 85 – Expected impacts of the proposed policy options on the measurement of Plato degree for sweetened/favoured beer in Germany**

Option	1.A / 2.A	1.B.1 / 2.B.1	1.B.2 / 2.B.2 (no change)
Approach	A	B1	B2 (Baseline)
<b>Average price of radler (EUR/hl)</b>	184	184	189
% Change in price	-2.2%	-2.2%	no change
<b>Average price of other sweetened/flavoured beer (EUR/hl)</b>	229	229	231
% Change in price	-1.0%	-1.2%	no change
<b>Overall consumption of sweetened/flavoured beer (hl)</b>	1,914,662	1,914,542	1,894,811
% Change over sweetened/flavoured beer	1.0%	1.0%	no change
% Change over total beer	0.0%	0.0%	no change
<b>Tax revenues from sweetened/flavoured beer (EUR)*</b>	12,779,642	12,794,961	19,806,253
% Change over revenues from sweetened/flavoured beer	-35.5%	-35.4%	no change
% Change over revenues from total beer	-0.9%	-0.9%	no change

**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Baseline year: 2015; \* Excise duty and VAT on excise duty.

## ➤ ITALY

As discussed above, Italy is undergoing a regulatory review process that embraces also the method for the measurement of Plato degree for excise duty purposes. According to some stakeholders, this may eventually result in a transition from approach B2 to B1, but since the competent authority has not yet adopted the secondary implementing regulation the outcome of the process is still uncertain (very likely a decision will be taken after the issuance of the CJEU judgement on the Polish case). Whereas taxes are currently computed based on approach B2 in our simulation we have assumed that the country has completed its transition to approach B1. It is important to highlight that this is a hypothetical assumption made for analytical purposes. Under this assumption, approach B1 is the baseline (and 'no change' scenario) while approach A and B2 are the 'change scenarios'.

Due to the country's relatively high excise duty rate (3.04 per hl/Plato degree) and the narrow market for sweetened/flavoured beer, which is dominated by radler, changing the measurement approach results in rather high percentage variations in tax revenues (excise duty and VAT on excise duty) generated by sweetened/flavoured beer when moving back from approach B1 to B2 (+72%). Changes from approach B1 to A are

rather minor.<sup>455</sup> Interestingly, in light of the very limited size of the Italian market for sweetened/flavoured beer, any change in consumption and tax revenues is marginal compared to the entire market for beer.

**Table 86 – Expected impacts of the proposed policy options on the measurement of Plato degree for sweetened/favoured beer in Italy**

Option	1.A / 2.A	1.B.1 / 2.B.1 (no change)	1.B.2 / 2.B.2
Approach	A	B1 (hypothetical dynamic baseline scenario)	B2 (Current situation)
<b>Average price of radler (EUR/hl)*</b>	238	238	254
% Change in price	-0.2%	no change	6.8%
<b>Overall consumption of sweetened/flavoured beer (hl)</b>	217,481	217,246	209,213
% Change over sweetened/flavoured beer	0.1%	no change	-3.7%
% Change over total beer	0.0%	no change	0.0%
<b>Tax revenues from sweetened/flavoured beer (EUR)**</b>	4,420,685	4,519,242	7,762,097
% Change over revenues from sweetened/flavoured beer	-2.2%	no change	71.8%
% Change over revenues from total beer	0.0%	no change	0.4%

**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Baseline year: 2015; \*Based on IWSR the Italian sweetened/flavoured beer market consists entirely of radler;<sup>456</sup> \*\* Excise duty and VAT on excise duty.

#### ➤ POLAND

In Poland, where tax revenues are the highest among sampled countries due to the larger size of the market for sweetened/flavoured beer, the changes are modest in absolute terms, as the market is dominated by flavoured beer other than radler and the national excise duty rate is moderate (EUR 1.86/hl/° Plato in 2015). Tax revenues (excise duty and VAT on excise duty) generated by sweetened/flavoured beer would fall by more than EUR 15 million when changing from approach B2 (baseline and no change scenario) to A or B1, i.e. about -1.5% when compared to total tax revenues on beer (more than one billion EUR). Impacts on consumption are more limited (-2.6% over consumption of flavoured/sweetened beer; -0.2% over total consumption of beer).

**Table 87 – Expected impacts of the proposed policy options on the measurement of Plato degree for sweetened/favoured beer in Poland**

Option	1.A / 2.A	1.B.1 / 2.B.1	1.B.2 / 2.B.2 (no change)
Approach	A	B1	B2 (Baseline)
<b>Average price of radler (EUR/hl)</b>	99	100	110
% Change in price	-9.4%	-9.2%	no change
<b>Average price of other sweetened/flavoured beer</b>	198	197	203

<sup>455</sup> As discussed previously, as the Italian authorities are still in the process of setting secondary rules to complete the transition from approach B2, it is still also possible a transition from B2 to A rather than to B1. In this respect, the impact analysis in Table 86 confirms that approaches A and B1 lead to very similar results in Italy. Therefore, the findings of the impact analysis performed in this Study remain largely valid, irrespective of whether Italy will eventually opt for approach A or B1.

<sup>456</sup> In Italy there is a small, but declining market for flavoured beer, which appears not to be recorded by IWSR data. Nonetheless, the Italian market for flavoured beer other than radler is dominated by beer with addition of flavour in the wort produced by craft brewers; the Plato degree of such beer is not affected by different measurement approaches. Hence, IWSR data allows capturing the entire market relevant to the policy problem.

Option	1.A / 2.A	1.B.1 / 2.B.1	1.B.2 / 2.B.2 (no change)
Approach	A	B1	B2 (Baseline)
(EUR/hl)			
% Change in price	-2.9%	-3.3%	no change
<b>Overall consumption of sweetened/flavoured beer (hl)</b>	2,445,951	2,448,589	2,384,762
% Change over sweetened/flavoured beer	2.6%	2.6%	no change
% Change over total beer	0.2%	0.2%	no change
<b>Tax revenues from sweetened/flavoured beer (EUR)*</b>	56,537,824	55,445,881	72,404,261
% Change over revenues from sweetened/flavoured beer	-21.9%	-23.4%	no change
% Change over revenues from total beer	-1.5%	-1.6%	no change

**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Baseline year: 2015; \* Excise duty and VAT on excise duty.

### ➤ ROMANIA

Finally, Romania would see no change if approach A were selected. Switching to from approach A (baseline and no change scenario) to approach B1 would make almost no difference, whereas switching to approach B2 would result in a 2.3% decrease in consumption of sweetened/flavoured beer (price of radler would increase by 5%; price of other sweetened/flavoured beer by 1%) and a 56% increase in tax revenues (including VAT on excise duty) generated by this type of beer. However, this corresponds to only -0.1% in total beer consumption and +0.8% in total tax revenue from excise duty on beer in Romania (i.e. less than EUR 2 million out of more than EUR 195 million).

**Table 88 – Expected impacts of the proposed policy options on the measurement of Plato degree for sweetened/favoured beer in Romania**

Option	1.A / 2.A (no change)	1.B.1 / 2.B.1	1.B.2 / 2.B.2
Approach	A (Baseline)	B1	B2
<b>Average price of radler (EUR/hl)</b>	92	93	97
% Change in price	no change	0.1%	5.1%
<b>Average price of other sweetened/flavoured beer (EUR/hl)</b>	222	221	225
% Change in price	no change	-0.2%	1.2%
<b>Overall consumption of sweetened/flavoured beer (hl)</b>	369,663	369,509	361,127
% Change over sweetened/flavoured beer	no change	0.0%	-2.3%
% Change over total beer	no change	0.0%	-0.1%
<b>Tax revenues from sweetened/flavoured beer (EUR)*</b>	2,692,520	2,700,865	4,190,476
% Change over revenues from sweetened/flavoured beer	no change	0.3%	55.6%
% Change over revenues from total beer	no change	0.0%	0.8%

**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Baseline year: 2015; \* Excise duty and VAT on excise duty.

### ➤ CUMULATIVE IMPACTS

Some general observations can be made. Whereas approach A and approach B1 are very similar, approach B2 leads to fairly different results. Table 89 summarises the impacts of switching from the baseline approach (A for Romania, B1 for Italy (hypothetical), B2 for

Austria, Belgium, Germany and Poland) to a different approach.

- It is apparent that selecting **approach A or B1** would result in an overall reduction in tax revenues (excise duty and VAT on excise duty) from sweetened/flavoured beer of more than EUR 30 million (about -25%), compared to the baseline situation. Consumption, on the other hand, might increase by about 100,000 hl (in the six countries combined), i.e. less than 2% of the total consumption of sweetened/flavoured beer. Limited changes in consumption reflect limited changes in prices (see country-level analysis above).
- Selecting **approach B2** would result in minor changes as opposed to the baseline approach since this is the approach currently in force in most of MS considered. In particular, slightly lower consumption and considerably higher tax revenues can be expected.

Expressing the changes as a percentage of the total beer market, the impacts become rather negligible: between +0.2% (moving to approach B2) to -1% (selecting approach A or B1) for tax revenues (including VAT on excise duty), and between almost nil (selecting approach B2) to +0.1% (selecting approach A or B1) for consumption volume.

**Table 89 – Aggregated impacts of the proposed policy options on the measurement of Plato degree for sweetened/favoured beer in the sample MS**

Option	1.A / 2.A	1.B.1 / 2.B.1	1.B.2 / 2.B.2	No change*
Approach	A	B1	B2	Baseline*
<b>Overall consumption of sweetened/flavoured beer (hl)</b>	5,970,569	5,972,599	5,851,811	5,868,381
% Change over sweetened/flavoured beer	1.7%	1.8%	-0.3%	no change
% Change over total beer	0.1%	0.1%	0.0%	no change
<b>Tax revenues from sweetened/flavoured beer (EUR)**</b>	95,247,370	94,157,454	131,410,006	126,669,196
% Change over revenues from sweetened/flavoured beer	-24.8%	-25.7%	3.7%	no change
% Change over revenues from total beer	-1.0%	-1.0%	0.1%	no change

**Source:** Author's elaboration of IWSR and EDT series.

**Note:** Baseline year: 2015; \*Approach A for Romania, approach B1 for Italy (hypothetical), approach B2 for Austria, Belgium, Germany, and Poland; \*\* Excise duty and VAT on excise duty.

### 3.6.2.3 Other impacts

Against this background, **public health impacts** potentially stemming from the harmonised adoption of either of the three approaches considered appear to be limited. In fact, the annual average per capita consumption of sweetened/flavoured beer in the six surveyed MS would range from 2.67 litres per annum (selecting approach B2) to 2.73 litres per annum (selecting approach A or B1).<sup>457</sup> The difference is clearly negligible when compared to average per capita consumption of 'standard' beer, which in sample MS exceeds 78 litres per annum.

When it comes to **enforcement**, any change in current approaches would require some MS to adapt their monitoring and control procedures. As mentioned, approach B2 is the most used, so the overall number of countries that would have to modify their systems would be limited. Moreover, approach B2 allows to perform checks directly on the end-products, with no need for on-site inspections and/or measurement during the

<sup>457</sup> Estimate based on Eurostat data for total population above 15 years.

production process, and is therefore consider more cost-effective than the other approaches. For these reasons, the selection of approach B2 at EU-level would have little or neutral effect on the enforcement costs for MS authorities.

Conversely, the customs authorities interviewed explained that, as things now stand, it is not possible to compute the parameters required to apply approach A or B1 by analysing the bottled 'end-product', since the current analytical methods do not allow to distinguish between beer and lemonade after mixing, nor do they allow separating the real extract from the present extract. Therefore, the enforcement of approaches A and B1 would require to perform checks at the production facilities, and these may generate new one-off costs to draft rules and install measurement equipment as well as recurring costs in the form of on-site inspections. An additional issue concerns sweetened/flavoured beer produced in another MS or third country, since the authority of the MS where the product is released for consumption could not directly conduct inspections and should rely on the information provided by the economic operators and/or, in certain circumstances, by the authority of the producing country. To prevent the risk of tax fraud, in case approach A or B1 is selected, it would be useful to put in place a coordinated mechanisms at EU-level for a streamlined and effective exchange of information.

While approach A and B1 lead to similar value of the Plato degree of sweetened/flavoured beer and somehow reflect its actual alcohol strength, approach B2 leads to higher Plato degree, possibly greater than the Plato degree of a standard beer with an equivalent alcoholic strength. For instance, approach B2 results in almost double the Plato degree of a typical radler when compared to approach A or B1 (Table 48). In principle, approach B2 is therefore more prone to generate possible **distortion of competition** between standard and sweetened/flavoured beer. However, as the impact analysis showed, the actual changes in price level that can be expected from switching between different approaches are rather modest (especially for sweetened/flavoured beer other than radler), and of limited importance vis-à-vis other competitiveness factors. So there is overall a negligible risk of an excessive market distortion caused by the selection of either of the three approaches considered.

Finally, the selection of a harmonised approach to measure the Plato degree of sweetened/flavoured beer would increase **legal certainty** and eventually reduce the risk of disputes between tax authorities and brewers. As discussed in the next Section, the effectiveness in this area may vary if the regulatory or the non-binding guidelines option is chosen.

#### 3.6.2.4 Effectiveness

As discussed above, policy option 1 and 2 have the same target (i.e. selecting a harmonised approach for the measurement of Plato degree of sweetened/flavoured beer) but are based on different measures: a regulatory amendment of Article 3(1) (option 1) or non-binding guidelines (option 2). The extent of the impacts expected clearly depend on the degree of adoption / compliance across MS. In the case of option 1 we can assume full compliance by all authorities, while the adoption of guidelines (option 2) would not be mandatory, so certain MS may not conform to the suggested measurement approach. This distinction is particularly important when it comes to impacts on legal certainty, since the persistence of disparities of interpretation across the EU may eventually encourage rather than decrease the risk of disputes between economic operators and tax authorities, especially in MS that would eventually not adopt the Commission's guidance.

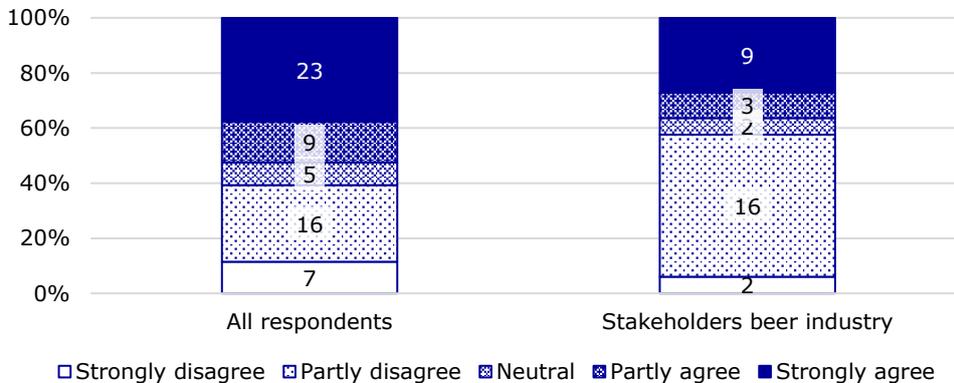
As things now stand, in some MS included in the sample, all stakeholders (including beer producers) would only reluctantly switch away from approach B2. In other MS, brewers exerted some pressure to stop using approach B2, despite the latter is the preferred

approach by tax authorities; these countries may be more open for a change. MS currently adopting approach A or B1 are unlikely to change to approach B2 unless binding changes are made in the Directive.

### 3.6.2.5 Public view on proposed policy options

The level of agreement of OPC participants on the proposed policy options returns a blurred picture. A small majority of respondent (53%) believe it is necessary to amend Article 3(1) of the Directive and to clarify the term 'finished product' with regard to sweetened/flavoured beer; however, a significant 38% of them disagree with this option (Figure 34). The percentage of stakeholders against an amendment of Article 3(1) grows if only beer industry respondents are considered (56%, against only 37% in favour of a policy change).

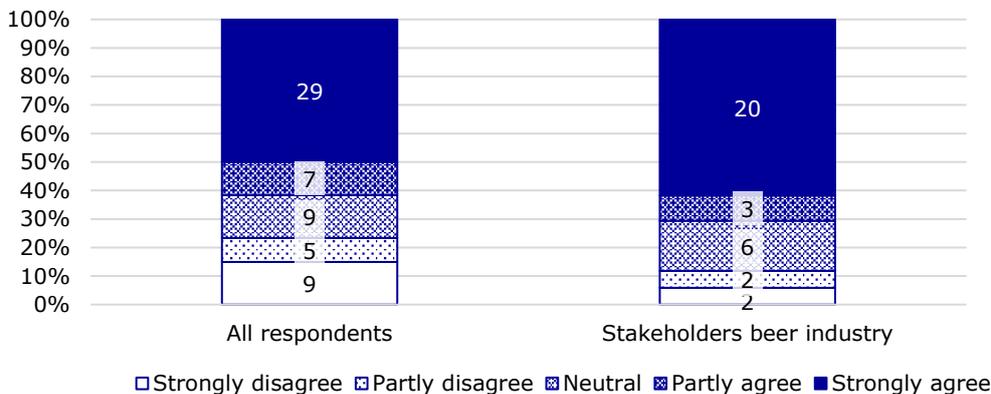
**Figure 34 – Public views on clarifying the term 'finished product' with regard to sweetened/flavoured beer**



Source: OPC.

There is instead greater consensus on the need to provide non-binding guidance on this issue: 61% of respondents (and 70% of beer industry stakeholders) are in favour of option 2 (Figure 35). In their qualitative contribution to the OPC, several industry players mentioned the need to adopt either approach A or B1, as approach B2 in their view is 'technically incorrect'. Interestingly, some respondents have emphasised that the most effective solution would consist in applying the ABV method (instead of the Plato degree method) to sweetened/flavoured beer. A few respondents seem particularly concerned of the uncertainty and significant room for tax fraud that would be generated by selecting approach A or B1.

**Figure 35 – Public views on providing guidance on methods for measuring the Plato degree of sweetened/flavoured beer**



Source: OPC.

## **4 COMPARISON OF OPTIONS AND CONCLUSIONS**

### **4.1 Classification of alcoholic beverages**

#### **4.1.1 Comparison of policy options**

##### **4.1.1.1 Uncertain scope of the OFB category**

The respective effects of the policy options analysed are summarised in the comparative Table 90 below. In particular, four scenarios have been considered:

- O. No change over the current situation, i.e. the tax treatment of 'borderline' products will continue being determined by the national interpretation of the subjective criteria laid down in CNEN notes 2206 00, and the legal and administrative rules and practices that individual MS have developed in this respect. This scenario includes the expected evolution in the near future (dynamic baseline).
- I. The introduction in the text of the Directive of the above CJEU criteria so as to allow the tax categorisation of certain 'borderline' products as 'ethyl alcohol', independently from CN classification and possible BTIs. This option implies the development of clear and agreed guidelines for the effective operationalisation of these criteria.
- II. The differentiation of the OFB tax category, currently laid down in Article 12, into two sub-categories with a different tax treatment. This option may be implemented in two different ways, with similar effects, i.e. by defining cider, perry and other specific beverages separately from other generic OFB – which would likely require a harmonised sectoral legislation, or by defining pre-mixes / RTDs etc. separately from other non-mixed OFB.
- III. No revision of the Directive, but possible clarification of CN / CNEN and/or the adoption of classification guidelines at customs level, plus other possible measures outside the scope of the current impact assessment process, like the adoption of a sectoral regulation on cider and other specific OFB.

The scenarios are compared with respect to the main impact areas identified and analysed in details in the previous Sections. For every impact area, a summary judgment is provided including (i) a rating of the positive or negative effect expected; and (ii) the main motivations underlying the rating. Needless to say, impact areas may have a different importance for the policy-making process so the ratings provided should not be aggregated straightforwardly.

**Table 90 – Comparison of options: review of the scope of OFB category**

Impact area	0) No Change	I) Clarify the excise duty structure for 'borderline' products	II) Introducing a differentiation in the OFB tax category	III) Other approaches not requiring a revision of the Directive
<b>Legal certainty</b>	<b>0</b> 'Difficult' cases are generally declining, especially thanks to the adoption of clearer classification rules at MS level. Disparities across MS may persist.	<b>+1</b> Improved coherence in the tax treatment of products within each country, but not necessarily across MS. Risk of inconsistencies with HS/CN coding and trade disputes.	<b>0</b> Useful to remove/reduce MS-level sub-categorisations. Limited effect on cross-country disparities. Risk of incentivising new 'borderline' products.	<b>+1/ +2</b> Clear CN / CNEN and robust guidelines may solve most of inconsistencies at the core of the problem. A harmonised definition of certain OFB like cider etc. would be more effectively adopted in sectoral legislation. Effectiveness mitigated by the non-binding nature of measures.
<b>Competition and market effects</b>	<b>0</b> Other factors than taxes influence market and competition more pervasively. Very limited cases of competition distortion reported. No change expected.	<b>0 / +1</b> Re-classification would lead to a significant reduction in sales of certain 'borderline' products especially in the category of 'borderline' IP, redressing some apparent malfunctioning. However, several non-target CN 2206 products would be unintendedly affected.	<b>0 / -1</b> Market impact depends on the tax rate applied to the new category: an IP-like treatment would lead to a collapse of low strength mixed drinks, 'borderline' cider as well as other non-target products. Drawing a demarcation line between 'traditional' cider and 'mass-market' products is sensitive and may easily result in competition issues.	<b>0 / +1</b> CN / CNEN review and guidelines may have similar benefits and drawbacks as (I). Sectoral legislation for cider may reduce the risk of competition issues.
<b>Tax revenues</b>	<b>+1</b> Tax revenues have kept increasing and the magnitude of the issue potentially caused by borderline products is modest and declining.	<b>0</b> The net effect on tax revenues is moderately negative due to the estimated elasticity of demand. No losses are actually expected due to substitution with other products that would likely occur.	<b>-1</b> Risk of losses if the tax rate applied is high (a 'per ABV' structure would have more balanced impacts). As for option (I) substitution would mitigate losses.	<b>0</b> Likely same impact as option (I).
<b>Administrative burden</b>	<b>+1</b> Limited in absolute terms and declining, thanks to the adoption of MS level approaches.	<b>-1 / +1</b> Negative in the short term due to one-off initial costs. Positive in the long term due to reduction of the burden to deal with complex cases.	<b>-1</b> Negative in the short term (as option I), with extra costs envisaged for updating the system. Not so effective in reducing the burden from complex cases.	<b>+1</b> Like option (I), but with reduced initial costs, since no action at the level of the excise duty system is required.

**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.1.1.2 Unclear application of the notion 'entirely fermented origin'

The comparison in this area is between the no change scenario (0) and one possible option (IV) for revision of the Directive (see Table 91 below), namely:

- O. The 'no change' scenario entails that MS continue to adopt at domestic level legal and administrative provisions to ensure a certain margin of tolerance for the addition of alcohol as a flavour carrier (AFC) or other functional purposes in manufacturing beverages that, according to the Directive, should be 'entirely of fermented origin'.
- IV. The policy option analysed consists of adopting a harmonised treatment of products containing AFC in the Directive, by either establishing a fixed threshold and/or allowing only the addition of the strictly necessary amount of AFC (both approaches can be currently found among MS).

The scenarios are compared with respect to the three impact areas identified and analysed in details in the previous Sections. For every impact area, a summary judgment is provided including (i) a rating of the positive or negative effect expected; and (ii) the main motivations underlying the rating. Needless to say, impact areas may have a different importance for the policy-making process so the ratings provided should not be aggregated straightforwardly.

**Table 91 – Comparison of options: clarify the treatment of AFC in products of 'entirely fermented origin'**

Impact area	0) No Change		IV) Clarify the treatment of AFC-containing products	
<b>Legal certainty</b>	<b>-1</b>	More MS will likely adopt domestic measures for AFC in the absence of a harmonised one, with increasing cross-country disparities. The ambiguity with the legal text of the Directive would persist.	<b>0 / +1</b>	Introducing a margin of tolerance for AFC in the Directive would reduce the legal ambiguity and disparities across MS. The adoption of a subjective approach (strictly necessary dose) may generate new areas of uncertainties. Conversely, a fixed threshold may not be always coherent with the principle of the 'strictly necessary dose'. A combination of the two approaches seems the most effective.
<b>Market effects</b>	<b>0 / -1</b>	It is possible (not demonstrated) that the ambiguity of the text constrains market development in certain MS.	<b>0 / +1</b>	More clarity and predictability may support market growth. In absolute terms, the volume of products at stake is very modest, so limited change in the overall market would be perceived.
<b>Tax revenues</b>	<b>0</b>	No relevant change expected.	<b>0 / -1</b>	No major changes expected. The adoption of a fixed threshold - higher than the strictly necessary dose - may translate in an excessive amount of alcohol (AFC) that is not taxed as 'ethyl alcohol'.

**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.1.1.3 Indefinite EPC for wine and OFB

The issue at stake does not call for a revision of the Directive but of other legal and administrative provisions underlying it (e.g. Regulation 684/2009, as well as the EMCS rules and procedures). Under certain circumstances, it may connect also to the policy Option (II) discussed in Section 4.1.1.1 above. The two scenarios described in Table 92 below, consist of:

- O. Maintaining the same EPCs for wine and OFB, i.e. W200 for still products and W300 for sparkling products.

- V. Introducing distinct EPC for OFB (sparkling and still). In the event of the establishment of a new tax category for certain OFB (Option II above), this new category may adopt these new codes, while the remainder may eventually remain under W200 / W300 since the tax treatment will continue to be similar. But for monitoring and control purposes it would be ideal to have a higher level of disaggregation.

The scenarios are compared with respect to the two main impact areas identified and analysed in the previous Sections. For every impact area, a summary judgment is provided including (i) a rating of the positive or negative effect expected; and (ii) the main motivations underlying the rating. Needless to say, impact areas may have a different importance for the policy-making process so the ratings provided should not be aggregated straightforwardly.

**Table 92 – Comparison of options: differentiate Excise Product Codes**

Impact area and target groups	0) No Change		V) Creating separate EPC for OFB	
<b>Administrative burden</b>	<b>0</b>	Not relevant.	<b>-1</b>	Legal and technical revisions required, both for economic operators and competent authorities. If the required change are limited to the OFB operators directly concerned the level of administrative burden would remain modest.
<b>Tax enforcement and revenues</b>	<b>-1</b>	In the few countries having different levels of rates for wine and OFB, the risk of 'misclassifications' may translate into incorrect excise duty levied and potential loss. The issue would be magnified by a possible adoption of a separate tax category for certain OFB.	<b>+1</b>	The risk of 'misclassifications' and ensuing tax losses would be bridged. Furthermore, there would be more clarity in the tax treatment as Article 8 or Article 12 of certain aromatised wine products, useful for market monitoring purposes.

**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.1.2 Summary of findings and conclusions

- The Directive defines the categories of alcoholic products subject to harmonised excise duty in accordance with their customs classification, i.e. the CN codes. The correspondence between the fiscal categories and the CN codes is however not straightforward, and certain novel products may take advantage in certain circumstances of an unduly favourable tax treatment. It has been observed that **classification uncertainties may lead to disparities of treatment** across MS and between similar products, due to **different criteria** used to determine the essential fermented character of certain beverages.
- 'Borderline' products can be found primarily in the tax categories of 'Other Fermented Beverages' (OFB) – especially low-strength mixed drinks and certain types of cider – and among 'Intermediate Products' (IP) – i.e. products with a fermented base that are in many respect equivalent to certain spirits-based beverages. In absolute terms, the **magnitude of the problem is modest and mostly stable**: 'borderline' products currently amount to an estimated 308 mn litres / year, i.e. less than 0.6% of the total market of alcoholic beverages in the EU. Nonetheless, for the tax categories concerned the issue is more substantial: nearly 17% of OFB and 24% of IP may consist of products to different extents exploiting an unduly advantageous tax treatment. Uncertainties with 'borderline' products may **increase the classification burden** for administrations and economic operators, which has been estimated around one million EUR per year.

- Three main policy options have been considered and assessed:
  - (i) **Revising the current definition of OFB and IP**, and establishing common criteria (and implementation methods) to identify products that have lost their fermented character and should be therefore assimilated to ethyl alcohol (in line with the landmark CJEU rulings).
  - (ii) **Splitting the OFB category into two sub-categories**, of which one would maintain the current treatment while the other – ideally comprising all ‘borderline’ products – would be defined and treated separately.
  - (iii) The third option encompasses binding and non-binding measures that **require no change of the Directive**, and in this sense are mostly outside the remit of the regulatory revision process. These measures are not strictly alternative to the other two options above, but rather complementary and include: clarifying certain subjective criteria laid down in the CN / CNEN (drawn from the CJEU rulings); adopting non-binding classification guidelines; promoting a sectoral regulation for cider; and measures to enhance market monitoring and control.
- All options may help **reduce the classification uncertainties**, but also **present downsides**. Option I would be effective in reducing the disparities of treatment of similar products in one country (also cutting the administrative burden), but not so effective against the risk that the same product is treated differently in different countries, and may cause troubles in external trade. Option II would enhance EU-wide harmonisation, reducing the need for special national taxes for specific categories of products (like ‘alcopops’, ‘pre-mixes’ etc.), but would not effectively address inconsistencies generated at CN level, and would impose additional burden to economic operators and tax authorities. As regards Option III, the revision of CN / CNEN and the adoption of detailed classification guidelines may pre-empt the need to modify the Directive, while the adoption of sectoral regulation for cider would facilitate a coherent enforcement of classification rules. The major difficulty with these measures is that they fall outside the current regulatory process, so they require the involvement and consensus of several different services of the national and European administrations.
- Under both regulatory options, the **market impact for the target products would be significant**, since their demand is quite sensitive to price. According to the results of the economic model used, a substantial decline of sales of ca. 80-200 mn litres/year can be predicted. This is a small amount if compared to the overall alcoholic beverage markets (less than 0.4% in the worst scenario), but substantial for the specific lines of products at stake. Regarding excise duty revenues, the decline in sales would not be entirely offset by the higher rates applied, so **a net loss in tax revenue can be expected** (down a maximum of EUR -247 mn) - very likely mitigated by consumer switching to other products.
- Both policy options **may unintendedly affect certain non-target products**, especially aromatised wine-based drinks and cocktails that are currently classified as ‘other fermented beverages’. The estimated market and fiscal impact for these products would be of the same scale of magnitude of target products (i.e. down approximately 78 mn litres / year), which may pose questions on the balance of such intervention.
- Another issue at stake regards the addition of minimal amounts of alcohol as a flavour carrier (AFC) or for other functional purposes to certain flavoured wine and OFB. This practice **seems in contrast with the ‘entirely fermented origin’ requirement** laid down in the Directive’s definition for these products. The evidence from fieldwork revealed that various MS have already adopted legal and administrative provisions establishing a margin of tolerance for products containing

AFC, and would be ***in favour of harmonised rules*** in this regard. The Study findings show that the adoption of similar approaches at EU level would reduce the existing uncertainties and possibly improve the market functioning, while the impact on tax revenues would be minimal.

- Finally, the ***lack of a separate EPC for 'Other Fermented Beverages'*** is not ideal for monitoring purposes and may fuel misclassifications and errors in excise duty payment, although the magnitude of concrete problems is minimal since most MS apply the same excise duty to wine and OFB. The introduction of a separate EPC for OFB would cause some initial (modest) administrative burden, which would be counterbalanced by improved clarity, reduced risks of errors and better market monitoring.

## 4.2 Exemptions for denatured alcohol

### 4.2.1 Comparison of policy options

#### 4.2.1.1 Incomplete / inconsistent mutual recognition of CDA

Table 93 below summarises and compares the expected impacts of the different policy options considered to address the problems stemming from the incomplete / inconsistent mutual recognition of completely denatured alcohol (CDA). It should be noted that, as discussed in Section 3.2.1, the scope for problems arising from the manifestly unclear rules on mutual recognition stipulated in the Directive has been greatly reduced with the recent developments regarding the so-called Eurodenaturant;<sup>458</sup> this is already factored into the baseline, i.e. the positive effects are deemed to have already occurred (and are therefore not reflected in positive scores in the table below). Complete harmonisation of the formulations across all MS has been discarded as unrealistic at the present time due to resistance from a few MS.<sup>459</sup> Therefore, only the following two options have been considered:

- A. No change to the current situation. This scenario includes the expected evolution in the near future (dynamic baseline).
- B. Amend Article 27(1)(a) to clarify that each MS has to recognise CDA produced in another MS using the formulations notified by that particular MS, but not any other MS.

**Table 93 – Comparison of options to address mutual recognition of CDA**

Impact area and target groups	A) No Change	B) Clarify mutual recognition
<b>Legal certainty</b>	<b>0</b> No change, although practical implications of uncertainty are less significant following adoption of CIR 2017/1112.	<b>+1</b> Avoidance of divergent interpretations involving MS that have notified formulations other than the 1-1-1 Eurodenaturant, disputes and associated costs.
<b>Functioning of the Single Market and competition</b>	<b>0</b> Most problems resolved by adoption of CIR 2017/1112; no further change.	<b>0 / +1</b> Reduction of any remaining trade barriers and distortions due to possible restrictive interpretation of mutual recognition by some MS.
<b>Operating costs and conduct of business</b>	<b>0</b> Most problems resolved by adoption of CIR 2017/1112; no further change.	<b>0 / +1</b> No impact on most businesses, as this would only codify the approach already taken by most MS. Minor positive impacts for producers that sell CDA to MS with different national formulations, and users of CDA in these MS.
<b>Enforcement costs for national authorities</b>	<b>0</b> No change.	<b>0</b> No change.
<b>Fiscal fraud and associated revenue, health risk</b>	<b>0</b> Risk of fraud with CDA reduced significantly by adoption of CIR 2017/1112; no further change.	<b>0</b> No change.

**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.2.1.2 Proliferation of national approaches to PDA

<sup>458</sup> See Commission Implementing Regulation (EU) 2017/1112.

<sup>459</sup> In particular CZ, which insists on keeping the 3-3-1 Eurodenaturant as well as its national CDA formulation used for the production of biofuels.

In addition to the baseline, four policy options were considered to address the issues that stem from the national approaches to so-called partially denatured alcohol (PDA), in particular the many different procedures / formulations that are authorised in the different MS. One of these (full harmonisation of PDA formulations) was discarded because it would not be politically feasible at the present point in time. The options that were assessed were therefore:

- A. No change to the current situation. This scenario includes the expected evolution in the near future (dynamic baseline)
- B. Amend Article 27(1)(b) to achieve partial harmonisation, i.e. a harmonised list of PDA formulations that is applicable across the EU, and the ability for MS to authorise different formulations for specific uses where the fiscal risk is demonstrably low (further preparatory work may be required before the Directive is amended)
- C. Develop a database of PDA formulations authorised by the MS to increase transparency, building on the existing JRC database which is currently not up-to-date and not accessible to industry (non-regulatory option)
- D. Support confidence / capacity building measures to enhance understanding and trust between the competent authorities of MS (non-regulatory option)

It should be noted that these options are not mutually exclusive, and could be taken forward in parallel.

The impacts of these options are summarised in Table 94 below. It should be reiterated that the compliance and administrative costs of the respective national supervisory regimes for denatured alcohol as such were not included in the analysis, since they are of purely national origin and relate only very indirectly to the Directive. It is also important to note that the scale of the benefits from the options is difficult to predict with confidence, as they are highly dependent on (1) the exact implementation of the options (e.g. the formulations included in a harmonised list), and (2) the specific situation and needs of individual economic operators depending on their size, sector, MS in which they are based, etc.

**Table 94 – Comparison of options to address problems stemming from the proliferation of national approaches to PDA**

Impact area and target groups	A) No Change		B) Partial harmonisation of PDA formulations		C) Database of national PDA formulations		D) Confidence / capacity building measures	
<b>Legal certainty</b>	<b>0</b>	No change expected	<b>+1</b>	Transparency and certainty increased, but not fully guaranteed due to continued use of exceptions Potential for disputes over what constitutes 'low fiscal risk'	<b>0 / +1</b>	Transparency increased, but only as regards those MS that operate a positive list of PDA formulations	<b>0</b>	No change
<b>Functioning of the Single Market and competition</b>	<b>0</b>	No change expected	<b>+1</b>	Reduced barriers to intra-EU trade, fairer competition between PDA producers and users in different MS	<b>0 / +1</b>	Slightly reduced barriers to intra-EU trade due to greater transparency	<b>0 / +1</b>	Highly uncertain – may lead to reduced barriers if MS adopt more consistent rules / practices as a result
<b>Operating costs and conduct of business</b>	<b>0</b>	No change expected	<b>+1</b>	Benefits for PDA producers and users that operate in more than one MS Possible positive or negative effects for users depending on whether the harmonised list is more or less exhaustive than the current national one	<b>0 / +1</b>	Minor cost savings for producers of PDA wishing to supply customers in other MS due to the increased transparency	<b>0 / +1</b>	Highly uncertain – may lead to reduced costs if MS adopt more consistent rules / practices
<b>Enforcement costs for national authorities</b>	<b>0</b>	No change expected	<b>-1 / +1</b>	Short-medium term: significant resources required for developing harmonised list Medium-long term: cost savings for authorities incl. laboratories	<b>-1 / 0</b>	Minor costs for building and maintaining the database up to date Minor savings for authorities who can refer to the database	<b>-1 / 0</b>	EU funding via the Fiscalis programme MS human and financial resources May lead to savings if MS adopt more efficient rules / practices
<b>Fiscal fraud and associated revenue, health risk</b>	<b>0 / -1</b>	Adoption of Eurodenaturant for CDA may displace fraud towards PDA	<b>0 / +1</b>	Reduced risk of fraud involving products containing 'weakly' denatured alcohol (if 'low fiscal risk' criterion is implemented strictly)	<b>0</b>	No effect	<b>0 / +1</b>	Highly uncertain – may lead to reduced risks if MS adopt stricter rules / practices

**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.2.1.3 Divergent interpretation of the terms of Article 27(1)(b)

In order to clarify the interpretation of Article 27(1)(b) and address the problems that are due to the current uncertainties, the following policy options were considered:

- A. No change to the current situation. This scenario includes the expected evolution in the near future (dynamic baseline)
- B. Amend Article 27(1)(b), to clarify the scope and main implications of the term 'used for the manufacture of', to include indirect uses such as the use of denatured alcohol in cleaning production lines
- C. Amend Article 27(1)(b) to include a reference to a 'recognisable finished product' and insert a note to the CN code to define that any product with an alcohol content above 90% ABV has to be classified as 2207

It should be noted that these options are not mutually exclusive; both options B and C could be taken forward in parallel.

**Table 95 – Comparison of options to address divergent interpretations of Article 27(1)(b)**

Impact area and target groups	A) No Change		B) Clarify 'used for the manufacture of'		C) Clarify 'recognisable finished product'	
<b>Legal certainty</b>	0	No change expected	+1	Enhanced clarity regarding the legal meaning and uses of 'partially' denatured alcohol Elimination of ambiguity and uncertainty regarding indirect uses of PDA	+1	Greater clarity as to when products containing PDA can be released for consumption Reduced risk of divergent / arbitrary interpretations by customs offices
<b>Functioning of the Single Market and competition</b>	0	No change expected	+1	More equal treatment of PDA for indirect uses across the EU	+1	More equal treatment of goods containing PDA across the EU
<b>Operating costs and conduct of business</b>	0	No change expected	+1	Cost savings for users of PDA in MS that currently do not exempt indirect uses Reduced risk of disputes and associated costs in future	0/ +1	Lower risk of delays / costs associated with disputes with customs Potential movement cost increases for a limited number of products
<b>Enforcement costs for national authorities</b>	0	No change expected	0	No change expected	0	No change expected
<b>Fiscal fraud and associated revenue, health risk</b>	0	No change expected	0	No change expected	+1	Reduced scope for intentional misclassification of PDA so as to avoid controls

**Legend:** +2 major positive effect expected; +1 moderate positive effect expected; 0 no effect or neutral impact expected; -1 moderate negative effect expected; -2 major negative effect expected.

#### 4.2.2 Summary of findings and conclusions

- Overall, the data collected and analysed as part of this Study suggests that the EU regulatory framework for exempting denatured alcohol from excise duty **works relatively well**. The majority of stakeholders consulted (including both national authorities and economic operators) felt the current rules at EU level, although complex, were fit for purpose, and there is no need for any fundamental changes to the current framework. Nonetheless, **problems can and do occur** due to (1) an incomplete / inconsistent mutual recognition of CDA, (2) the proliferation of national regulatory approaches to PDA, and (3) divergent interpretations of certain terms related to PDA. It is evident (inter alia from the frequent discussions within the Committee on Excise Duty and the Indirect Tax Expert Group) dating

back to 2008) that the provisions in Article 27 concerning denatured alcohol are not phrased in a completely clear and unambiguous way, which has given rise to uncertainties and disputes, especially when denatured alcohol is to be moved across borders between MS whose interpretation of the applicable rules do not coincide. Some of these uncertainties have non-negligible cost implications for producers and/or users of denatured alcohol, and can inhibit intra-EU trade in denatured alcohol. However, the evidence suggests that only a limited number of economic operators in specific circumstances have been affected. There are also concerns about fiscal fraud with denatured alcohol, which is estimated to result in **lost tax revenues in the region of EUR 150-200 million per year across the EU** (the bulk of which is in certain Central / Eastern European MS).

- Regarding the mutual recognition of **'completely' denatured alcohol (CDA)** produced in different MS, the unclear wording of the Directive has in the past led to a number of problems, primarily when economic operators wanted to produce or use CDA using a formulation notified by a MS other than their own. There have also been cases of fraud involving certain national CDA formulations. However, with the recent adoption of a common Eurodenaturant by a large majority of MS, the likelihood of these kinds of problems occurring in the future (and therefore the negative impacts) is greatly reduced. Nonetheless, since not all MS are able to agree on a single CDA formulation, **a clarification of the wording of Article 27(1)(a) would be beneficial** to eliminate the remaining ambiguity, and thereby avoid potential future disputes.
- The non-harmonised approach to **'partially' denatured alcohol (PDA)** is welcomed by most stakeholders, as it allows MS to balance the needs of their national industry with the need to minimise the fraud risks in the way they deem most appropriate. However, the proliferation of national procedures and formulations can create uncertainties, risks and/or costs when more than one jurisdiction is involved – though larger firms are typically able to overcome these, while smaller ones tend to have few economic incentives to source denatured alcohol from abroad. **There are also known cases of fraud** involving products which have been manufactured with alcohol that has been denatured with a 'weak' formulation (e.g. because the smelling and/or tasting agents are relatively easy to remove / mask, and the absence of a chemical analytical marker makes it difficult for the competent authorities to detect the alcohol is illicit).
- In theory, a **complete harmonisation of PDA formulations** for different sectors could further facilitate cross-border trade in PDA and alleviate the fraud-related concerns. However, this would require MS to agree on compromise solutions to reconcile their (sometimes very restrictive, sometimes very flexible) views on the formulations they are prepared to authorise. Recent attempts to achieve such a compromise for certain sectors failed, and many MS seem not willing to accept full harmonisation, due to the potentially large cost implications for (certain sectors of) their national industries.
- **Partial harmonisation seems therefore more effective.** It would involve agreement on a harmonised list of PDA formulations that is applicable across the EU, while allowing MS that wish to do so to authorise different formulations for specific uses where the fiscal risk is demonstrably low. This would enhance legal certainty and transparency to a significant extent, and thereby facilitate cross-border operations as well as further restrict practices that might give rise to fraud, without requiring the minority of MS who currently authorise specific, tailored PDA formulations for individual users to categorically stop doing so. This option may require further preparatory work on the harmonised list and the definition of the concept of low fiscal risk, before these could be enshrined in the Directive itself. 'Softer' policy options, such as a database of national formulations and/or EU-funded measures to enhance confidence and trust between competent national

authorities could also be considered, although the benefits these would generate are likely to be more limited.

- The text of Article 27(1)(b) should be amended so as to clarify the wording and address two issues that continue to cause uncertainties and discrepancies, namely:
  - Clarify that the term 'used for the manufacture of' includes indirect uses (such as cleaning manufacturing equipment and production lines). This would ensure a fairer treatment across the EU and reduce the costs for users in the minority of MS that currently do not consider that PDA used for these purposes qualifies for the exemption.
  - Clarify what can be considered a 'finished product' containing PDA that can be exempted from excise duty and released for consumption. This would enhance legal certainty and help reduce the risk of fraud by limiting the scope for the misclassification of PDA mixed with very small quantities of other substances (which should still be subject to controls under the duty suspension regime).

## 4.3 Reduced rates for small producers

### 4.3.1 Comparison of policy options: small brewers

The reduced rates for small brewers proved to work well, as demonstrated by the Commission Report and as acknowledged in the Council Conclusions. The baseline analysis singled out two areas where problems of a modest magnitude were identified: (i) the definition of the conditions for 'independent brewer', and (ii) the application of the discount to small brewers engaging in intra-EU trade. To address these problems, the Commission may decide to launch a revision of the Directive, providing for a clarification e.g. introducing provisions in an Annex to the Directive, or publishing a set of non-binding guidelines.

On the basis of the impact analysis carried out in Section 3.3.2 above, the comparison via a multi-criteria analysis of the policy options at stake, including the no change scenario is provided in Table 96 below. For every impact area, a summary assessment follows, including (i) a rating of the positive or negative effect expected (between -2 and +2); and (ii) the main motivations underlying the rating. Needless to say, impact areas may have a different importance for the policy-making process, so the ratings provided cannot be summed or aggregated.

**Table 96 – Comparison of options on reduced rates for small brewers**

Impact area and target groups	A) No change	B) Legislative revision	C) Non-binding guidelines
<b>Legal certainty for economic operators and public authorities</b>	<p><b>0/ - 1</b></p> <p>As the market for small breweries is evolving, business relationships may become more complex and cross-border flows are likely to increase, thus increasing the risk of legal uncertainty for economic operators.</p>	<p><b>+1</b></p> <p>A binding revision would provide more legal certainty. However, as the small breweries segment is growing and changing fast, it risks becoming outdated or to be circumvented in the medium term.</p>	<p><b>+1 / +2</b></p> <p>Non-binding guidelines present the risk of MS not adapting their national frameworks. However, a certain degree of consensus already exists among MS authorities, and non-binding interventions have already proved effective in defining the conditions of application of reduced rates.</p>
<b>Administrative burdens for economic operators</b>	<p><b>+0</b></p> <p>The reduced rates for small brewers do not generate unnecessary administrative burdens and no evolution is expected.</p>	<p><b>0/ - 1</b></p> <p>A small increase of administrative burdens could be expected in case a uniform certificate for small brewers is introduced. Impact is estimated at 7.5% of the current burdens. Negligible increase in case the ex-post approach based on customs-to-customs verification is adopted.</p>	<p><b>0/ -1</b></p> <p>The choice of a non-binding instrument would not entail any change in administrative burdens, which would be the same as under the legislative revision.</p>

Impact area and target groups	A) No change		B) Legislative revision		C) Non-binding guidelines	
<b>Enforcement costs for public authorities</b>	<b>0 / -1</b>	Enforcement costs are considered to be minimal by tax and customs authorities. Increased complexity and cross-border flows may lead to small incremental costs.	<b>-1 / -2</b>	Public authorities would incur additional costs under both approaches, and higher in case the ex-ante uniform certificate is adopted. Enforcement costs would be concentrated in countries not having implemented the reduced rates for small operators.	<b>-1</b>	Under the non-legislative option, the EU uniform certificate cannot be adopted, and hence enforcement efforts are lower.
<b>SME competitiveness</b>	<b>0 / +1</b>	More players are likely to benefit from the reduced rates, given the growth of the small brewery market segment.	<b>+1</b>	More legal clarity and ease of doing business for cross-border operators would improve the competitiveness of SME, and facilitate the consolidation of medium players. However, given the limited scale of the problem, positive impacts are expected to be modest.	<b>+1</b>	Same impacts as described under the binding revision. However, their magnitude could be lower if MS decide not to conform to the non-binding guidelines.
<b>Cross-border market effects for economic operators</b>	<b>0 / -1</b>	The expected increase in cross-border flows may lead to a modest increase in the impacts of the minor disturbances to the Single Market identified.	<b>+1</b>	A more uniform approach to the application of reduced rates to small brewers would facilitate the ease of doing business for cross-border operators. However, given the limited scale of the problem, positive impacts are expected to be modest.	<b>+1</b>	Same impacts as described under the binding revision. However, their magnitude could be lower if MS decide not to conform to the non-binding guidelines.

**Legend:** +2 major positive effect expected; +1 moderate positive effect expected; 0 no effect or neutral impact expected; -1 moderate negative effect expected; -2 major negative effect expected.

#### 4.3.2 Comparison of policy options: small distilleries

The uptake of the reduced rate scheme for small distilleries is low, given that only 7 MS opted in for it. Moreover, the number of operators covered is limited, given the output threshold set in the Directive (10 hlpa). In particular, it is claimed that the threshold is too low for a small distillery to be commercially viable, and hence, that the reduction concerns only ancillary activities. It can then be concluded that the current threshold could explain, in part, the limited uptake of this provision.

An impact analysis was carried out in Section 3.3.4 above to verify what the effects of a higher threshold would be. The comparison of the two variants proposed (100 hlpa and 10,000 hlpa thresholds) and the baseline scenario is done by means of a multi-criteria analysis, summarised in Table 97 below. For every impact area, a summary assessment follows including (i) a rating of the positive or negative effect expected (between -2 and +2); and (ii) the main motivations underlying the rating. Needless to say, impact areas may have a different importance for the policy-making process, so the ratings provided cannot be summed or aggregated.

**Table 97 – Comparison of options on reduced rates for small distilleries**

Impact area and target groups	A) No change	B) Raising the threshold to 100 hlpa	C) Raising the threshold to 10,000 hlpa
<b>Tax revenues for public authorities</b>	0 Foregone revenues are negligible and unlikely to change in the near future.	0/ -1 The number of operators and their market share would increase, but would remain low (e.g. 0.4% of the current market for ethyl alcohol in Poland). As a consequence, foregone revenues would increase, but would remain low (estimated at 0.2% of the current revenues from ethyl alcohol).	-2 The reduction would cover mid-size operators and possibly a significant share of the market for spirits in certain MS. Given the duty rates for ethyl alcohol, which are higher than those for other beverages, foregone revenues could be substantial.
<b>Market effects for economic operators</b>	0 The provision has no or negligible impacts on commercial operators, and no change is expected.	0/ -1 Some very small commercial distilleries would fall below the threshold, but their market share is estimated to be marginal. As a consequence, market distortions and negative effects on commercial operators above the threshold would be small.	-1 Given the fact that 10,000 hlpa represent a sizeable part of the ethyl alcohol market, and given the weight of excise duties over the price of spirits, important market distortions would be introduced as a result of the new threshold.
<b>Health impacts for consumers</b>	0 The provision did not affect the overall consumption or production of ethyl alcohol, and would not do so in the near future.	0/ -1 Given the small market segment that would be covered, no material effects on the price and consumption of spirits would materialise. Hardly any health impact would be caused by this option.	-1 In the case of spirits, the reduction of the excise duties, and thus the potential impact on price, would be larger than for beer. As a consequence, part of the discount could be passed-on downstream, with a possible increase in the consumption of spirits and, thus, in per capita alcohol consumption.
<b>SME competitiveness</b>	0 The provision largely does not apply to commercially-viable operators.	0/ +1 Few very small players would be covered by the measure, and would thus benefit from lower rates, resulting in higher profitability. However, most of the commercial SME in the spirits market would remain outside the scope of the provision.	+2 The new provision would greatly benefit the majority of SME in the spirit sector, the bulk of which would fall below the threshold.
<b>Administrative burdens for economic operators</b>	0 Administrative burdens are minimal and will remain so.	0/ -1 The change of the threshold would increase the number of operators concerned, and hence total burdens. However, burdens per applicant are expected to be low – in line with those for small brewers.	0/ -1 The change of the threshold would increase the number of operators concerned, and hence total burdens. However, burdens per applicant are expected to be low – in line with those for small brewers.
<b>Enforcement costs for public authorities</b>	0 Enforcement costs are minimal at the moment, and there is no indication that	0 to -1 A rise in the number of operators would increase enforcement costs for public authorities. However, the revenues at stake would be too small	-2 A large number of operators and a significant size of the market would be covered by the reduction. Given the comparatively higher duty rates on ethyl alcohol,

	the provision require additional efforts in the future.		to require the deployment of significant additional resources.	additional enforcement resources should be deployed to limit the risk of abuses and tax frauds.
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**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

### 4.3.3 Comparison of policy options: small producers of other beverages

The Council gave mandate to the Commission to investigate the impacts of an extension of the reduced rates to small producers of wine, other fermented beverages and intermediate products. The analysis is carried out in Section 3.3.4 above, based on a framework which takes into account the reduced rates schemes already provided to small brewers and distillers, and product-specific thresholds. To analyse the market structure and define a threshold, the analysis is product-specific and focuses on the most representative products: still wine for wine, cider for other fermented beverages, and fortified wine for intermediate products. It is acknowledged that the application of the reduced rates would extend to the whole fiscal category.

Table 98 below summarises the impacts of the policy options at stake, i.e. the extension of the rates to new product categories, including the baseline scenario. Importantly, option B, C, and D are not mutually exclusive, meaning that the Commission could decide to implement some or all of them. For every impact area, a summary assessment follows, including (i) a rating of the positive or negative effect expected (between -2 and +2); and (ii) the main motivations underlying the rating. Needless to say, impact areas may have a different importance for the policy-making process, so the ratings provided cannot be summed or aggregated.

**Table 98 – Comparison of options on reduced rates for small producers of other products**

Impact area and target groups	A) No change	B) Introducing reduced rates for small wine producers	C) Introducing reduced rates to small producers of other fermented beverages	D) Introducing reduced rates to small producers of fortified wine
<b>Tax revenues for public authorities</b>	<p>0</p> <p>Reduced rates cannot be granted to small producers of wine, OFB, and IP, and thus no costs arise for public budgets.</p>	<p>-1</p> <p>Foregone revenues amount to 7% of the current revenues from still wine, or EUR 440 mn at EU level. The impacts arise only in the MS where wine is taxed at a positive rate.</p>	<p>0 / -1</p> <p>Impacts are estimated as negligible in most of the sample MS, and modest in Ireland and the UK. Total foregone revenues at EU level estimated at about EUR 15 mn.</p>	<p>0 / -1</p> <p>As small producers have a limited market share, foregone revenues are estimated to be low.</p>
<b>Market effects for economic operators</b>	<p>0</p> <p>The regulatory framework for alcoholic beverages foresees different treatment for different producers. However, the situation is not expected to change.</p>	<p>0 / -1</p> <p>Only producers established or selling their products in MS with a positive tax rate would see their position improving. The provision could produce distortive effects in certain countries, because of the higher excise burden over the price of wine.</p>	<p>+1</p> <p>Small cider makers would gain relatively to large producers. Market effects are estimated to remain small, given the limited amount of sales covered by the reduction.</p>	<p>0</p> <p>Market effects are estimated to be negligible, given the limited amount of sales covered by the reduction.</p>
<b>Health impacts for consumers</b>	<p>0</p> <p>As there are no reduced rates for wine, OFB and IP, per capita alcohol consumption is not affected.</p>	<p>0 / -1</p> <p>At EU level, the market significantly affected by the reduction – 4% of still wine consumption – is too small to trigger changes to per capita health consumption. These could arise in countries with a relative higher taxation of wine (Scandinavian countries, UK, and Ireland).</p>	<p>0 / -1</p> <p>At EU level, the amount of alcoholic beverages concerned is very limited. Impacts could be noticeable only in MS with a large cider market (such as UK and Ireland).</p>	<p>0</p> <p>The market potentially concerned by the reduction is too small to trigger any significant health impact.</p>
<b>SME competitiveness</b>	<p>0</p> <p>Current competitiveness of small producers will remain unchanged if no intervention is brought forward.</p>	<p>+1</p> <p>The effects would be positive, but uneven. Only producers established or selling their products in MS with a positive tax rate would benefit from the reduction. Furthermore, the provision would not benefit very small players which do not vinify on their own.</p>	<p>+2</p> <p>The competitiveness of small cider makers would be greatly enhanced by the provision. Diseconomies of scale and market access barriers could be counterbalanced.</p>	<p>+1</p> <p>Most of the small operators in the value chain would have no access to the discount, as they do not produce fortified wine, but confer their production to larger players.</p>

<b>Administrative burdens for economic operators</b>	<b>0</b>	The lack of reduced rates for wine, OFB and IP generates no administrative burdens.	<b>-1</b>	Administrative burdens for beneficiaries from reduced rates are estimated to be modest, at 1.2 €/hl. Total burdens at EU level would amount to about EUR 5.3 mn.	<b>0 / -1</b>	Administrative burdens for economic operators are estimated to be negligible to low, as in the case of wine and cider.
<b>Enforcement costs for public authorities</b>	<b>0</b>	The lack of reduced rates for wine, OFB, and IP generates no enforcement costs for public authorities.	<b>-2</b>	The number of operators potentially involved would be high. Importantly, most of the reduced rates would benefit cross-border operators, creating implementation problems, already experienced in the case of beer.	<b>0 / -1</b>	The number of operators concerned and the amount of excise revenues at stake would not require significant additional resources.

**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.3.4 Summary of findings and conclusions

- Member States have the option of granting reduced excise duty rates to small producers of beer and ethyl alcohol, in order (i) to support the competitiveness of SME *vis-à-vis* large players, in the case of beer, and (ii) to protect traditional productions, in the case of ethyl alcohol. Reduced rates cannot be granted to small producers of wine, OFB, and intermediate products. This may affect conditions for competition, and prevents MS from pursuing the same policy objectives in the markets for the excluded categories.
- In the 23 MS that have adopted **reduced rates for small brewers**, the scheme is estimated to cover 95% of active breweries, and 5% of the production (about 17 million hl), and causes very modest foregone tax revenues (ca. 1% of the revenue from beer) and negligible administrative costs for operators. Two minor areas of improvement have been identified, which could be tackled by means of a legislative revision or non-binding guidelines:
  - **Improving the clarity of the definition of 'independent brewer'** and the conditions for recognising such brewers. In this area, non-binding measures (e.g. guidelines) seem more flexible and easier to update.
  - **More straightforward application to cross-border operators**, e.g. by establishing a mandatory uniform certificate for operators, or by means of an appropriate system for exchanging data among national authorities (the latter not requiring a legislative revision).
- These measures may generate benefits in terms of legal certainty, competitiveness of SME, and cross-border trade, although on a limited scale given the small share of the market concerned. The implementation burden would also be modest, although concentrated on the customs authorities of the MS where reduced rates are currently not in place. Enforcement difficulties should be carefully considered when choosing among the different options.
- As far as **small distilleries** are concerned, reduced rates are implemented in only seven MS and cover a very small number of operators. In particular, the very low threshold of 10 hlpa per year established in the Directive in practice **restricts this facility to ancillary spirit production**, which represent a negligible share of the market. Therefore, the option of raising this threshold moderately (to 100 hlpa) or significantly (10,000 hlpa) has been assessed in the Study. Under the first scenario the impact would be limited, since only very small commercial operators would gain access to the facility, whereas under the second scenario mid-size commercial operators would also be covered. So, the competitiveness of SME in the spirits market would be largely enhanced under the latter scenario, but this may also generate market distortions, substantial reductions of the excise duty revenues collected, negative public health effects, and the need to scale up monitoring and enforcement efforts.
- Finally, the Study examined the possibility of **introducing this option for the categories of products** not currently covered, namely wine, OFB and intermediate products. The magnitude of the problem and the expected impacts would not be uniform:
  - For still wine, the scope of application would be limited, as 78% of the market is currently subject to zero rate. Moreover, small producers may already receive support to improve their competitiveness in the form of exemptions from several requirements of the excise legislation. Conversely, stakeholders perceive the risk that this option may eventually translate into the introduction of positive minimum rates at EU level.

- The competitive position of small cider makers *vis-à-vis* large producers is similar to that of small breweries, so the introduction of reduced rates for this category may have beneficial effects on their development with limited adverse effect in terms of foregone revenues and administrative burdens. The lack of a harmonised sectoral legislation on cider may represent an obstacle to an equitable implementation of the scheme.
- Finally, extending reduced rates to small producers of fortified wine would trigger impacts which are, on the one hand, limited, and, on the other, uneven across operators active in the same value chain. Moreover, it would be somehow redundant with the reduced rates extended under Article 18.4 of the Directive.
- Reduced rates may incite consumption, with negative public health effects especially in MS where these products are popular and standard rates are high.

## 4.4 Reduced rates for low-strength alcohol

### 4.4.1 Comparison of policy options

In light of the results of the impact analyses, a multi-criteria analysis is performed to compare each policy option with the no change scenario (Table 99 and Table 100). In particular:

- **Option 1** consists in raising the threshold for reduced rates applicable to low-strength beer from the current 2.8% vol to 3.5% vol.
- Similarly, **Option 2** regards a possible increase of the thresholds for reduced rates applied to wine, intermediate products and ethyl alcohol.

Both options touch upon the same impact areas and the overall effects are similar. In the comparison, full-compliance from MS is assumed, also where MS are in fact unlikely to adopt reduced rates even in the case of increased thresholds.

For each impact area, a summary assessment is provided, including: i) a rating of the positive or negative effect expected (between -2 and +2); and ii) the main motivations underlying the rating. It is worth stressing that impact areas may have a different importance for the policy-making process, therefore ratings cannot be summed or aggregated.

**Table 99 – Comparison of options on increasing the threshold of reduced rates for low-strength beer**

Impact area	No Change	Option 1
<b>Tax revenues</b>	<b>0</b> MS will keep applying the current structure and excise duty rates.	<b>-1</b> In MS opting for the new provision, an additional share of beer consumed will benefit from reduced rates, thus tax revenues would decline.
<b>Market effects</b>	<b>0</b> No change in taxation; therefore, no change in price and consumption.	<b>+1</b> In MS opting for the new provision, low-strength beer will pay lower tax. Depending on the extent to which the discount is passed on to consumers, its price will decline and its consumption will increase.
<b>Public health</b>	<b>0</b> No change in consumption, therefore, no impacts on public health.	<b>-1</b> Public health impacts are negligible due to limited consumption growth in absolute terms (up to 0.1 L per capita of additional beer consumption) but some population groups e.g. youth, (pregnant) women could be adversely affected.

**Legend:** +2 major positive effect expected; +1 moderate positive effect expected; 0 no effect or neutral impact expected; -1 moderate negative effect expected; -2 major negative effect expected.

**Table 100 – Comparison of options on increasing the threshold of reduced rates for other low-strength products**

Impact area	No Change	Option 2
<b>Tax revenues</b>	<b>0</b> MS will keep applying the current structure and excise duty rates	<b>-1</b> In MS opting for the new provision, an additional share of wine, intermediate products and ethyl alcohol consumed will benefit from reduced rates, thus tax revenues would decline.
<b>Market effects</b>	<b>0</b> No change in taxation; therefore, no change in price and consumption.	<b>+1</b> In MS opting for the new provision, producers of AWP, mixed drinks and some traditional intermediate products might benefit from new market opportunities. As tax on consumption of low-strength alcohol will be lower, depending on the extent to which the discount is passed-on, consumers will pay a lower price and consumption is expected to grow.

Impact area	No Change	Option 2
<b>Public health</b>	<b>0</b> No change in consumption, therefore, no impacts on public health.	<b>-1</b> Public health impacts remain ambivalent, since low-strength beverages may substitute consumption of standard alcoholic beverages or other soft-drinks. Negative health effects may be caused by the better tax treatment of certain products appealing for young people and women (e.g. FAB).

**Legend:** +2 major positive effect expected; +1 moderate positive effect expected; 0 no effect or neutral impact expected; -1 moderate negative effect expected; -2 major negative effect expected.

#### 4.4.2 Summary of findings and conclusions

- Articles 5, 9, 13, 18, and 22 of the Directive allow MS to apply reduced rates on low-strength alcoholic beverages. **The level of uptake of this option across MS is uneven**, primarily due to the specificities of national fiscal priorities and targets rather than to lack of clarity on its objective in the text of the Directive. Furthermore, there is scant evidence on its potential contribution to public health objective (i.e. in the form of a reduction of the overall per capita consumption of alcohol). In fact, **tax reductions for low-alcohol beverages may affect consumers' behaviour in opposite ways**: on the one hand reducing the amount of pure alcohol consumed by regular consumers, on the other hand potentially encouraging the initiation of abstainers (including young persons) to the consumption of alcoholic beverages.
- For each product category, the Directive establishes the thresholds under which MS may apply reduced rates. From a market perspective, these thresholds are of limited relevance (with the exception of OFB), since **only a small share of existing products are eligible**. Therefore, the Study investigates the possibility of raising the existing thresholds to encourage MS uptake and, by consequence, more pervasive effects.
- In the case of beer**, there is some consensus among stakeholders – with a few notable exceptions – on the benefit of **raising the current threshold to 3.5% vol.** This amendment would expand the scope of application, and eventually encourage the development of this segment of the market. In fact, lower taxation may result in lower retail prices (depending on the extent to which the discount is passed on to consumers) and encourage price-sensitive consumers to shift from stronger products. The proposed option may lead to **foregone tax revenues of about 1%** of the current level. The price reduction may generate a small increase in per capita consumption of low-alcohol beer (between +2 cl and +10 cl per year based on a sample of MS).
- As regards the other alcoholic beverages, there is limited appetite for revising the current thresholds, and no alternative thresholds have been proposed. Furthermore, higher thresholds for intermediate products and ethyl alcohol may eventually turn out advantageous for certain new products like mixed drinks that are particularly appealing to young people, thus resulting in negative impacts for public health policies.

## 4.5 Exemptions for private production

### 4.5.1 Comparison of policy options

Under the current Directive, there is an unequal treatment among alcoholic beverages with respect to the exemption for private production for own consumption: MS can apply it to fermented beverages (including beer, wine and other fermented beverages), whilst this is not possible for intermediate products and ethyl alcohol. The policy option considered in Section 3.5.1 above would redress this situation by extending the exemption to any alcoholic beverage, henceforth covering private distillation as well.

However, as explicitly called for by the Council mandate, the right balance should be struck between such an extension and the risk of (unintended) negative effects. To assess such a balance, an impact analysis has been developed in Section 3.5.2 above. On the basis of this impact analysis, the comparison, via a multi-criteria analysis, of the policy option at stake with the no change scenario is provided in Table 101 below. For every impact area, a summary assessment is provided, including (i) a rating of the positive or negative effect expected (between -2 and +2); and (ii) the main motivations underlying the rating. Needless to say, impact areas may have a different importance for the policy-making process, so the ratings provided cannot be summed or aggregated.

**Table 101 - Comparison of options: extension of the exemptions for private production**

Impact area and target groups	A) No Change	B) Extension of the exemption to intermediate products and ethyl alcohol
<b>Tax revenues for public authorities</b>	0/ +1  Private distillation is expected to decline in most of MS, so that part of the currently illicit consumption would be substituted by commercial products.	-1  The option would not lead to any recovery of foregone revenues. In addition, due to the partial substitution of existing spirit consumption, the option would have a small negative impact on tax revenues, estimated at EUR 45 mn and 0.3% of excise revenues from ethyl alcohol in the at EU level (between 0.1% and 0.6% of the current excise revenues in each sample MS).
<b>Market effects for economic operators (including cross-border)</b>	0  Market effects are considered negligible (in AT, FI, IT, and UK), modest in PL, and significant only in RO. Given the current trends, there is no indication that the situation is going to worsen in the future. Cross-border spill overs were not identified.	0/ -1  This policy option would result in a modest increase in private distillation. As a consequence, negative market effects for legal operators would also modestly increase, due to the partial substitution of market consumption with private distillation (up to -0.3% of the spirit market). Cross-border effects remain negligible.
<b>Health impacts for consumers</b>	0/ +1  Private distillation is expected to decline in most MS, and so are intake of privately-distilled alcohol and the risk of methanol poisoning.	-1  The exemption would result in an increase of private distillation, and, thus, to a corresponding higher consumption and risk of adverse events. Also, new private distillers may be less familiar with the methanol removal process.
<b>Enforcement costs for public authorities</b>	0  Private distillation is considered a no or limited issue in most of the sample MS (AT, FI, IT and the UK), or a lower enforcement priority compared to other forms of illicit alcohol (PL and RO). As such, it does not absorb significant enforcement resources and is unlikely to do so in the future.	0/ -1  It is likely that MS would introduce a light form of regulation of private distillation (as it is already the case in AT and RO). As a consequence, a modest increase to enforcement costs is expected from this policy option.

<b>Administrative burdens for private distillers</b>	<b>0</b>	Only where private distillation is legal (AT and RO), individuals bear a limited amount of administrative burdens, and this is unlikely to change in the future.	<b>0/ -1</b>	Even though the extension of the exemption would remove private distillers from the scope of the excise framework, real savings of administrative burdens would be negligible, as hardly any private distiller currently complies with the applicable administrative regulation. National forms of regulation (if introduced) could generate additional administrative burdens.
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**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.5.2 Summary of findings and conclusions

- MS can exempt from the payment of excise duties the production of 'fermented beverages' (i.e. beer, wine and other fermented beverages) for own consumption. With very limited exceptions, this activity is unregulated. On the contrary, such an exemption is rarely granted to the production of spirits and fortified products, as private distillation is considered more dangerous from a public health perspective. The exclusion of intermediate products and ethyl alcohol **may constitute a case of unequal treatment**, which may need to be redressed, if no significant negative effects are triggered.
- The **amount of illicit private distillation is estimated to be low** in most of the countries reviewed (between 0.5% and 2.5% of the current market for spirits), and more significant in a couple of them (respectively 3.5% and 6%). At EU level, it is estimated to represent about 2.3% of the spirits market. Foregone excise revenues in the six sample MS examined amount to about EUR 100 mn (1.4% of the revenues from ethyl alcohol); at EU level, **tax losses can be estimated at about EUR 250 mn** (1.6% of the revenues from ethyl alcohol).
- The option to introduce an exemption for private production of intermediate products and ethyl alcohol would have **modest but negative impacts** in terms of tax revenues (EUR -45 mn, or -0.3% of the excise revenues from ethyl alcohol at EU level), and market effects (-0.1% of the current production of spirits). Additionally, it could be harmful from a public health perspective since it may increase: (i) the risks of methanol intoxication; (ii) the accessibility and consumption of distilled products. The option is also likely to generate some additional administrative burdens and enforcement costs for public authorities. In any case, MS that would not take up this option would bear minimal negative spill overs, as cross-border effects are estimated to be negligible.

## 4.6 Measurement of Plato degree for sweetened/flavoured beer

### 4.6.1 Comparison of policy options

Based on the above impact analysis, Table 102 provides a comparison, via a multi-criteria analysis, of the policy options at stake with the no change scenario. For each impact area, a summary assessment is provided including: i) a rating of the positive or negative effect expected (between -2 and +2); and ii) the main motivations underlying the rating. As impact areas may have a different importance for the policy-making process, such ratings cannot be summed or aggregated. In this context, it is worth reiterating that both options (1 and 2) potentially lead to results of the same kind, since both consists of selecting a harmonised approach (A, B1 or B2) to measuring the Plato degree of sweetened/flavoured beer. In addition, the two options can be complementary; in fact, an amendment of the Directive (option 1) could be accompanied by further guidance on measurement approaches (option 2). For this reason it seemed more informative to present the comparison of option by selected approach instead of by regulatory or non-regulatory measure (adding qualifications where required). In particular:

- **Option 1.A and 2.A** would select approach A, i.e. 'base beer' approach, by either an amendment of Article 3(1) (option 1.A) or through Commission's guidelines (option 2.A).
- **Option 1.B.1 and 2.B.1** would select approach B1, i.e. the 'real extract' approach. Option 1.B.1 would entail a Directive amendment, while option 2.B.1 the adoption of non-binding guidelines.
- **Option 1.B.2 and 2.B.2** would select approach B2, i.e. the 'present extract' approach, by either an amendment of Article 3(1) (option 1.B.2) or through Commission's guidelines (option 2.B.2).

It is worth stressing that the awaited decision of the CJEU on the Polish case (Box 21) may help clarifying how to interpret Article 3(1) for sweetened/flavoured beer and eventually affect the baseline/no change scenario, since non-compliant MS may be required to revise their measurement method.<sup>460</sup> As discussed, the CJEU is called to rule on whether the Plato degree of sweetened/flavoured beer should be measured by considering either the 'real extract' (approach B1) or the 'present extract' (approach B2). The Court is not asked to decide whether the calculation of the Plato degree should be done before adding sugar (i.e. on the 'base beer') or after adding sugar (i.e. on sweetened beer). Nonetheless, it should not be excluded a broad ruling, providing an interpretation of the term 'finished product'.

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<sup>460</sup> In each MS, the no change scenario represents the approach that is currently into force (Austria, Belgium, Germany, Poland and Romania) or will possibly be adopted in the near future (Italy) in the absence of any EU intervention.

**Table 102 – Comparison of options: alternative methods for measuring the Plato degree of sweetened / flavoured beer**

Impact area	No Change/ baseline		Option 1.A/2.A		Option 1.B.1/2.B.1		Option 1.B.2/2.B.2	
<b>Tax revenues</b>	<b>0</b>	MS will keep applying their preferred approach.	<b>-1</b>	This approach leads to a lower Plato degree for sweetened/flavoured beer. Most MS will have to change their current approach.	<b>-1</b>	This approach leads to a lower Plato degree for sweetened/flavoured beer. Most MS will have to change their current approach.	<b>0</b>	This approach leads to a higher Plato degree for sweetened/flavoured beer. Few MS will have to change their current approach.
<b>Market effects</b>	<b>0</b>	No change in taxation; therefore, no change in price and consumption.	<b>+1</b>	In most MS, sweetened/flavoured beer will pay lower tax. Depending on the extent to which the discount is passed on to consumers, price will decline and consumption will increase.	<b>+1</b>	In most MS, sweetened / flavoured beer will pay lower tax. Depending on the extent to which the discount is passed on to consumers, price will decline and consumption will increase.	<b>0 / -1</b>	In few MS, sweetened/flavoured beer will pay higher tax. Depending on the extent to which the additional tax is passed on to consumers, price will increase and consumption will decrease.
<b>Public health</b>	<b>0</b>	No change in consumption.	<b>0</b>	Public health impacts are negligible due to limited consumption growth.	<b>0</b>	Public health impacts are negligible due to limited consumption growth.	<b>0</b>	Public health impacts are negligible due to limited consumption reduction.
<b>Enforcement costs</b>	<b>0</b>	MS will keep applying current enforcement procedures.	<b>-1</b>	Most MS will have to implement new enforcement procedures to test the Plato degree of sweetened/flavoured beer and perform on-site checks. Coordination at the EU level required for beer moved across borders.	<b>-1</b>	Most MS will have to implement new enforcement procedures to test the Plato degree of sweetened/flavoured beer and perform on-site checks. Coordination at the EU level required for beer moved across borders.	<b>+1</b>	All MS will be able to measure the Plato degree of sweetened/flavoured beer based on the analysis of the final product
<b>Market distortion</b>	<b>-1</b>	Some competition distortions in MS applying approach B2 are possible, and may grow with the growth of sweetened/flavoured beer market.	<b>+1</b>	Approach A does not create relevant disparities in the level of taxation of sweetened/flavoured beer and standard beer of the same alcohol strength.	<b>+1</b>	Approach B1 does not create relevant disparities in the level of taxation of sweetened/flavoured beer and standard beer of the same alcohol strength.	<b>0 / -1</b>	Approach B2 may create disparities in the level of taxation of sweetened/flavoured beer and standard beer of the same alcohol strength. Since most of MS already adopt approach B2 and the market of these products is small, the overall impact on market functioning would be modest.
<b>Litigation costs</b>	<b>0 / +1</b>	The pending CJEU judgment (C-30/17) may eventually shed light on the correct interpretation of the terms 'finished product'.	<b>+1</b>	Increased legal certainty (yet, in the short-run non-binding guidelines may increase litigation costs).	<b>+1</b>	Increased legal certainty (yet, in the short-run non-binding guidelines may increase litigation costs).	<b>+1</b>	Increased legal certainty (yet, in the short-run non-binding guidelines may increase litigation costs).

**Legend:** **+2** major positive effect expected; **+1** moderate positive effect expected; **0** no effect or neutral impact expected; **-1** moderate negative effect expected; **-2** major negative effect expected.

#### 4.6.2 Summary of findings and conclusions

- Article 3(1) of the Directive allows for levying excise duty on beer with reference either to the Plato degree or ABV strength of 'finished product'. This Article results in different interpretations when it comes to measuring the Plato degree of sweetened/flavoured beer, i.e. mixture of beer with non-alcoholic additives or beverages. In particular, there seems to be three different approaches (A, B1 and B2) to measuring the Plato strength of sweetened/flavoured beer:
  - Approach A measures the Plato degree of the base beer, prior to the addition of sugar/flavours.
  - Approach B1 measures the Plato degree of the final product after the addition of sugar/flavours taking into account only the 'non-fermented (real) extract', i.e. the extract of the base beer without considering sugar/flavours added to the sweetened/flavoured beer after fermentation.
  - Approach B2 measures the Plato degree of the final product after the addition of sugar/flavours taking into account the 'present extract', i.e. the extract of the sweetened/flavoured beer including also the sugar/flavours added.
- Different approaches lead to different values of the Plato degree. In particular Approach A and B1 generally result in a lower Plato degree than Approach B2. Such difference has evidently an **impact on the applicable excise duty**. Assuming the excise duty is consistently passed-on to retail price, it may also affect **the competitiveness of products and the related demand** and ultimately cause disparities of treatment and potential distortion of the market. The different methods are also the basis of a legal dispute that has been brought before the CJEU, whose judgment is still pending.
- To address the problems caused by diverging interpretations two policy options have been considered: (i) a review of Article 3(1) to clarify what is meant by 'finished product'; and (ii) the issuance of guidelines to harmonise the calculation methods. Overall, **the option consisting in reviewing Article 3(1) seems more effective**, since non-binding measures cannot ensure compliance from all MS and would therefore not eliminate the risk of legal disputes, and related costs for both authorities and brewers.
- Since the CJEU case is still ongoing, the Study does not recommend any of the possible interpretations, but focuses on assessing the impact from the three different scenarios. In particular:
  - Approach B2, would result in only minor changes since it is already the choice of several MS. The change in the overall market volume would be negligible and the tax revenue from beer would increase by +0.2%.
  - Approaches A and B1 would have a similar market impact: sales may decrease by -1% and tax revenue may increase by 0.1%.
  - Furthermore, Approaches A and B1 would generate higher enforcement costs than approach B2, as customs laboratories cannot measure the tax base by checking the Plato degree of the end-product; rather, they would need to perform checks at the production facilities.

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