

**Study analysing possible changes in the minimum
rates and structures of excise duties on alcoholic
beverages**

**Executive Summary to
EC DG Taxation and Customs Union**

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Executive Summary

In 2004, the Commission produced a report which recommended that the minimum rates of duty laid down in 1992 should be revalorised to take account of the inflation that has occurred since then (COM(2004) 223 final). The report also noted problems in the classification and categorisation of alcoholic products for excise purposes such that, in some cases, the same product was classified under different categories (and hence subject to different taxation) in different Member States.

The overarching objective of the present study is to examine whether the current structures of alcohol taxation and the minimum rates laid down for the various categories are adequately supporting the effective functioning of the internal market, or whether distortions are caused and adaptations would be appropriate.

The study has two main specific aims, namely to provide an:

- Assessment of the current burdens of taxation and economic relationships between the different types of alcoholic beverages in different Member States;
- Assessment of the economic impact on the particular beverages and on the different Member States of potential changes to the alcohol directives compared to the current *status quo*.

1.1 Definitions and references used in the study

The present report uses specific terminology and definitions for key terms throughout the study. This is especially relevant when referring to the names by which the beverages are commonly known in the market, when referring to the precise beverage categories which are subject to different duty arrangements (as specified in the EC Directives), or when using other technical definitions or classifications proposed in this same context.

In fact, one of the findings of this report is that alcohol products are commonly referred to in different ways without being clear on the meaning and delimitation of the terminology used. As will be seen, this can have important consequences, especially because of differences in the way products may be categorised in the market and the way these products are classified for taxation purposes.

To avoid such terminology problems, we propose a definition for each of the key terms used in the study. Such definitions (explained in detail in the full report) are used consistently throughout the report.

1.2 Data sources used

We have used multiple sources of data to address different parts of the analysis undertaken in the study. Data sources used are the following:

International Wine and Spirit Record; Excise Administration Responses; Trade associations responses; EC Directives on alcohol and alcoholic beverages; Excise Duty Tables: Duties; Excise Duty Tables: Tax receipts; Taxes in Europe; FISCALIS (2005); COM(2004) 223 final; and other publications from the trade.

1.3 Structure of the full report

The structure of the full report is the following. In Section 2 we describe the European alcohol market. The current situation of the tax regime in the EU27 is analysed in Section 3. The list of problems with the current system in relation to the internal market; and the classification of beverages are described in Section 4 and Section 5. Section 6 simulates the impact of different policy options for change suggested by the Commission, and Section 7 concludes. A description of all the analyses supporting our research is provided in the Annexes.

1.4 Context

Alcoholic beverages are important to Governments and consumers in the EU.

Excise duties on alcoholic beverages constitute an important source of tax revenue in the EU27. Duties are an important contribution to Member States' finances and revenues range from 0.2% to 3.5% of total tax revenues (excluding Social Security). Total duty receipts in the EU27 amounted to €30.6 billion in 2007 (ETHYL ALCOHOL: 46% of revenues, BEER: 33% and WINE: 19%).

Consumption of alcoholic drinks is important in the EU: the total consumption stood at 56 billion litres in 2007, approximately 113 litres per person. Beer was by far the most consumed alcoholic drink, counting for 66% of the total volume. The second most consumed product, wine, accounted for 25% (14.1 billion litres).

1.5 The current tax regime

The Community framework concerning excise duty on alcohol and alcoholic beverages is laid down in two Directives.

- Directive 92/83/EEC was designed to harmonise the structures of alcohol taxation (specifying amongst other things the categories of product that are subject to excise duty arrangements).
- Directive 92/84 lays down minimum rates for the categories of product. Member States have a degree of flexibility in setting the levels of taxation as long as these minimum rates are complied with.

The definitions used to specify the structures for classifying products are to a large extent reliant on how a product would have been classified, at the time the Directive was adopted, under the customs nomenclatures 2203, 2204, 2205, 2206, 2207, and 2208. The structures for classifying products under Directive 92/83/EEC are categorised, in broad terms, as follows:

- BEER – All products classified to 2203 and beer mixed with non-alcoholic beverages classified to 2206;
- WINE – All products classified to 2204 and 2205 not exceeding 15% abv provided that the alcohol is entirely fermented; or not exceeding 18% provided that the alcohol is entirely fermented and no enrichment has been used;
- OTHER FERMENTED BEVERAGES (fermented beverages other than wine and beer) – Those products, not falling as beer and wine, which are classified to 2204, 2205 and 2206 and do not exceed 10% abv; or not exceeding 15% abv provided that the alcohol is entirely fermented;
- INTERMEDIATE PRODUCTS – All products between 1.2% and 22% abv classified to 2204, 2205 and 2206 which do not fall under the beer, wine and fermented beverage categories. Member States also have discretion to treat products that would fall under the fermented beverages category as Intermediate Product so long as the product exceeds 5.5% abv and the alcohol is not entirely of fermented origin;
- ETHYL ALCOHOL – (a) All products classified to 2207 and 2208, even when they form part of a product that is classified under another heading. (b) Any product classified to 2204, 2205 and 2206 that exceeds 22% abv.

Directive 92/84 only provides indication on the minimum rates, and Member States can freely set their duties as long as they are above the minimum rates specified in the Directive.

As a result, the standard duty rates in the different Member States show a huge disparity.

- BEER duties range from €1.87 to €23.6 per % abv per hl of product;

- ETHYL ALCOHOL duties range from €562 to €5,155 per hl of pure alcohol;
- STILL WINE duties range from €0 to €328 per hl of product;
- INTERMEDIATE PRODUCTS duties range from €45 to €515 per hl of product; and
- OTHER FERMENTED BEVERAGES duties range from €0 to €273 per hl of product.

It is noticeable that the duty rates in FI, UK, IE and SE are systematically the highest (top four) within each EC category. Compared with these countries, the duty rates in the remaining Member States are substantially closer to each other and to the minimum rate.

1.6 Identified problems

The current situation causes a number of concerns for the proper functioning of the internal market. We have identified the following problems.

Lack of transparency of the classification system

The classification procedures used by Member States for allocating beverages into the different categories are very heterogeneous. Member States use the 5-product system specified in the Directives, but there are a significant number of exceptions where alternative duties exist under certain conditions. Duties are sometime levied in different units across Member States which make comparisons difficult (abv or Plato can be used to measure strengths of beer, and, in some Member States, duties can be levied by volume of beer – with duty rates banded by strength – rather than directly by degree of alcohol).

Information on the classification systems used by different Member States is not readily available. It is also difficult to understand the criteria used to classify each type of beverage, as there is not clear description of the criteria used for delimitation of the categories.

Lack of harmonisation in duty rates

There is a very wide dispersion of before-duty (pre-tax) prices of the alcohol beverages consumed within the EU and the current duties accentuate such differences further. In particular, for all beverages there is a wide disparity between the high rates charged by four Member States (FI, S, IE, UK) and the rates charged by the rest of EU Member States. At present, because of their low level relative to the high rates charged by the four, the minimum duty rates contribute little to reducing such disparities.

There is also disparity in the duties being charged across beverages. The most noticeable difference is that, in general, a unit of alcohol has a much reduced rate when it is categorised under OTHER FERMENTED or WINE, rather than under BEER, ETHYL ALCOHOL or INTERMEDIATE PRODUCTS.

In addition, the directive also allows for reduced rates for small-producing units. Whilst a generous tax treatment helps raise the competitiveness of the small producers' final product, the artificial binary separation of producers by size necessarily creates scope for mid-size producers to be at a competitive disadvantage to both small and large producers. It is beyond the scope of this study to assess the presence of any such effect.

Minimum duty rates out of date

The minimum rates set in 1992 are clearly out-of-date. Prices increased by 44% from 1992 to 2010 and minimum rates have remained constant. This means that the minimum rates are lower in real terms than they were in 1992.

Large differences between neighbouring Member States

There exist large differences in post-duty prices of similar products between neighbouring countries. The largest differences are observed between UK and FR; FI and EE; and SE and DK. There are also some significant differences involving new Member States, particularly between EL and BG (ETHYL ALCOHOL), several Member States and AT (OTHER FERMENTED SPARKLING), and PL and several Member States (OTHER FERMENTED STILL).

Cross-border trade (legitimate shopping and smuggling)

As a result of large differences in market prices between neighbouring Member States, the volume of smuggling and cross-border shopping between these countries is significant.

Duties change relative prices of alcoholic beverages

An interesting issue to consider is whether the differences between pre- and post-tax prices of product pairs are likely to change the relative prices of alcoholic beverages (and hence potentially influence consumer behaviour). The results of our analysis illustrate that taxation changes the relationship between products, so that consumers see significant differences when comparing the relative prices of pre- and post-tax products.

Duties not being used as a trading barrier

Nevertheless, we have not found any relationship between the presence of such differences and wine- or beer-producing countries, and we cannot conclude that this practice is being used to discriminate between imported and domestic products. One limitation of our analysis is that we used an average or representative product to compare between product pairs for grouped beverages of BEER, ETHYL ALCOHOL, and WINE categories. We believe it could still be possible to discriminate against imported products making use of the different range of reduced rates and exceptions (for example, by setting up the duty rates such that they are directed to tax a type of imported products which certain characteristics or alcohol content). Although this is something we did not investigate, it means that Member States could make use of this possibility (even in the future) to hinder free movement of goods in the EU.

Classification problems

At present, there is lack of clarity among Member States over the treatment of beverages in cases where amounts of ethyl alcohol have been added to a fermented beverage. Member States apply different *ad hoc* rules which are not specified within the current classification framework. The lack of a common framework or agreement on how to treat such beverages across the EU results in uncertainty for operators.

There is the lack of certainty over treatment of products that have been either subject to a cleaning-up process (ultra filtration, reverse osmosis, etc), or that are produced using cleaned-up alcohol. Although such products still have a small market share at present, the different treatment of such products between Member States means that there is heterogeneity in the treatment of such products. Again, this results in uncertainty for operators.

Lack of clear definition

There is lack of a clear definition and delimitation of the terminology used in the sector. It has been found that stakeholders generally use CN and EC categories interchangeably. For example, in many cases ETHYL ALCOHOL is simply referred as CN 2208. This may be the case in many instances but it may not be always true.

Lack of data availability

Currently, there are scarce data on several interesting aspects of the alcohol market.

This mainly relates to data on the use of sweeteners and dyes, and the prevalence of cleaned-up alcohol and added alcohol in the production of alcoholic beverages.

Whilst these currently affect a relatively small proportion of the overall alcohol market, such factors present some of the more contentious problems with regard to transparency of categorisation and uniformity in application of duty rates. Furthermore, advances in technology and potential changes in consumer preferences make the need to standardise excise duty procedures quite important in the near future.

1.7 Analysis of policy options

The analysis of the policy options summarises what we believe to be the most pertinent changes resulting from adopting them. These are the off-trade price, since this is the tradable price across borders, and the total revenue from duty receipts, since this is the tax benefit to the Exchequer. Both changes are compared with the current situation (that is, with no changes to the directives).

Finally, an assessment is undertaken on the effectiveness of the different options in addressing the identified problems. The likely impacts on other outcomes (such as the on-trade market, tax revenues, profitability and competitiveness), and sensitivity of the results to changes in the parameters used is also presented as part of the final assessment.

Proposed options

The Commission suggested a large variety of policy options, which fall into two types of policy changes: a change in the level of the minimum excise duties (D), and a change in the structure (S) of the classification of alcoholic beverages. For some policies, several sub-options were considered, denoted by a lowercase suffix.

Option 1: Change in minimum excise duty rates (D)

The first option relates to a change in minimum duties in the different categories. The following options are analysed:

D1: Introduction of a minimum rate for WINE and OTHER FERMENTED BEVERAGES;

D2: Revalorisation of minimum rates for beverages.

Option 2: Changes in the structure (S)

The second option changes the structures of the categories in the following way:

- S1: Remove option for SPARKLING products to be charged different duty rates to STILL products;
- S2: Reclassify all products currently categorised as ETHYL ALCOHOL and below 22% abv to be categorised as (STILL) INTERMEDIATE PRODUCTS (attracting the same duty rates, minimum rate, all on the basis of the volume of the product);
- S3: Create new optional category, into which all RTDs (regardless of alcohol base) could be classified, which is subject to the same minimum rate as ETHYL ALCOHOL;
- S4: Create new product category for all products currently categorised as ETHYL ALCOHOL and below 22% abv, and all products with added alcohol, with duties and the minimum rate set on the basis of alcoholic strength, and with the minimum rate calculated as the unitary equivalent of the existing minimum rate for INTERMEDIATE PRODUCTS;
- S5: Unitary taxation on all products with minimum rates calculated for three categories based on alcoholic strength (1.2-15% abv, 15-22% abv, >22% abv) without regard to the type of beverage;
- S6: Abolish reduced rates for low-strength alcoholic beverages.

Evaluation approach

The policy options analysed will have different type of effects. In our analysis we provide an evaluation of the effectiveness of the policy options in:

- Reducing the disparity in duty rates (and prices) for the alcoholic beverages; and
- Bringing clarity to the classification of beverages.

Assessment of options

Some options have been excluded from our assessment analysis. This is because we believe that they are not significantly different from others. For example, options D1a, D1b, D2a and D2b are all options which variously affect the minimum rates applicable to each beverage category, of which D2b makes the largest increases. Hence, we will describe D1a, D1b, and D2a as

nested in D2b, as D2b results in at least the same effects as its subordinate options.

We present a summary of the effects of the policy options in **Table 1**, distinguishing between the different concerns that the policy options might affect. Some options have been designed to simply update the minimum rates (and hence reduce disparity in prices across Member States), while other options aim to reduce the uncertainty in the classification of drinks and different tax treatment across Member States.

Table 1: Effects of policy options overall								
Policy concerns	Policy option							
	D2b	S1	S2	S3c	S4a	S4b	S5c	S6
Minimum rates more relevant to current duty rates across EU	✓			✓			✓	
Small impact on (almost all) MS duty receipts		(✓)	✓	✓	✓	✓		✓
Reduce incentive for illicit and cross-border trade		✓						
Similar drinks treated in the same way		✓	✓		✓	✓	✓	
Common rules for all operators across the EU			✓	✓	✓	✓		✓
(Minor) simplification & transparency of categorisation		(✓)	(✓)	(✓)	✓	✓	✓	✓
Transparency of duty rates across categories					✓		✓	
Movement toward non-discriminatory tax system		✓	✓	✓	✓	✓	✓	✓
Affordability substantially lower in some/all sectors	✓							✓
Competitiveness substantially worsened in some/all sectors	✓							✓
Potential for negative impact on employment	✓							✓

Note: Options:

D2b: min rate for WINE and OTHER FERMENTED + 44% revalorisation all min rates

S1: SPARKLING == STILL

S2: ETHYL ALCOHOL <22% == (STILL) INTERMEDIATE PRODUCTS

S3c: Apply minimum rates for ETHYL ALCOHOL to RTDs (44% revalorisation of minimum rates)

S4a: ETHYL ALCOHOL <22% abv and ALL PRODUCTS with added alcohol == INTERMEDIATE PRODUCTS + unitary taxation

S4b: ETHYL ALCOHOL <22% abv and ALL PRODUCTS with added alcohol == INTERMEDIATE PRODUCTS + taxation in bands

S5c: ALL PRODUCTS into three categories according to alcoholic strength + unitary taxation (44% revalorisation of minimum rates)

S6: Abolish reduced rates for low-strength alcoholic beverages

The analysis illustrates some of the trade-offs that may need to be weighed in choosing between policy options. Policy options, such as D2b and S6, which affect small sections of the market, create relatively small changes in bias compared with the status quo, but have the (short-term) advantage of being easy to understand and to prescribe. Policy options, such as S4a and S5c, bring a degree of uniformity to actual duty rates by expressing them in unitary terms, and thus transparency to comparison of duties across products. However, they may be considered too far removed from the status quo to be politically viable.

In general, the different policy options have only a minor effect in reducing the disparity in duties across the Member States. One particularly noteworthy conclusion is that the 44% revalorisation of the minimum rates (including the introduction of non-zero minimum rates for WINE and OTHER FERMENTED) results in only a small price effect compared with the prevailing price differences, in particular between Member States with low duty rates and the four Member States with highest rates.

By definition, some of the policy options do not have a large effect on duty revenues, but it is important to note that Member States may not necessarily wish to achieve revenue neutrality in the face of any policy changes, and, indeed, may find it preferable from a policy perspective to set their duty rates in a different profile to those we have assumed for the purposes of our modelling exercise. It should also be noted that it appears very unlikely that a change in policy will be able to make duty rates converge across Member States and simultaneously maintain revenue neutrality.

Other policy options, such as S3 and S4, which ensure that certain beverages are classified in the same fashion across all Member States make a small difference, but will not have a great effect if there is disparity in the actual rates charged under either the old or new categorisation.

Illicit trade and cross-border shopping predominantly involve the major product categories (beer, wine and spirits), so policy options that might reduce incentives must address price differences between Member States in those products. Since, on the whole, the policy options suggested do not systematically achieve this, it seems unlikely that the policy options suggested will make a substantial difference to such cross-border activity. One exception to this could be S1, which would reduce the incentive to purchase sparkling products (mainly wine) in Member States with lower rates.

Nevertheless, looking forward, policy options which link the minimum rates to inflation may serve to limit future increases in price disparity, if some Member States decide for policy reasons to increase their duty rates in the future.

Almost all the structural policy options (those prefixed with 'S') would achieve greater transparency and uniformity in the classification system, and bring more transparency to the comparison of rates on different products. However, the degree to which the policy options move toward a non-discriminatory tax system is varied, and none go quite as far as suggesting a single unitary rate for all alcoholic products within a Member State (even S5 allows three different categories for different strength drinks).

There may be good reason for failing to go as far as full uniformity, which would increase the relative duty on lower-strength drinks (versus higher-strength drinks) when compared with the status quo. Although the cross-price effects may be small, this nevertheless represents an incentive toward purchasing and consuming higher strength alcohol, which may present health and social pitfalls.

Summary and outcomes

Our analysis of the policy options suggests that there are some which warrant further reflection, bearing in mind the limitations presented by political realities and considerations of the wider social impact of any changes.

We highlight the benefits of the following policy options: D2b, S4a, S6 and S1. We bear in mind that the effects could be less than in our analysis, if Member States seek exceptions for particular products, such as local specialities, which had previously not needed special treatment due to other flexibilities in the duty rate and classification system.

As a result of D2b the following impacts are expected:

Off-trade: prices will increase

- BEER 4% or more in BG, DE, MT, and RO, below 2% in CZ, ES, FR, and LT.
- ETHYL ALCOHOL 16% in BG, 7% in CY and by less than 4% in RO and SI.
- INTERMEDIATE PRODUCTS substantially BG (10%) and less than 3% in remaining Member States.
- OTHER FERMENTED BEVERAGES: ES and SK (18%) and in CZ around (11%).
- WINE: significant in BG (24%), in AT, DE, ES, HU, IT, PT, RO, SI, and SK (14% or more), and CY, FR, MT, (10%).

Cross-border shopping: the increases observed in off-trade markets as a result of the policy will not reduce significantly the price differences

across the EU. In particular, there will be no significant reduction in the differences between neighbouring Member States with significant cross-border trade at an EU level. There may be some reduction in such activity in Member States which border the countries that currently charge low rates, but, conversely, there is the potential risk that it could encourage cross-border activity from sites external to the EU.

On-trade: the increase in prices will be significantly less than the one observed for the off-trade. This is because duties represent a smaller share of the final price in the on-trade market.

Shift in demand: there will be no major changes in prices of BEER, ETHYL ALCOHOL, and INTERMEDIATE PRODUCTS as a result of this option and this will have reduced impact on demand. As there will be significant increases in the prices of WINE and OTHER FERMENTED BEVERAGES, consumption will decrease for these drinks.

Profitability: as a result of a reduction in consumption revenue will be lost and it is very likely that this will affect profits in the wine and other fermented sectors.

Tax treatment: the significant increase in the duties of WINE and OTHER FERMENTED BEVERAGES will reduce the differences in tax burden between beverages, and in particular in relation to the ones having a zero minimum rate.

Competitive position: the significant increase in the prices of WINE and OTHER FERMENTED BEVERAGES will change the relative price between these beverages and BEER, ETHYL ALCOHOL, and INTERMEDIATE PRODUCTS. To the extent that consumers are willing to substitute between these products this may shift the demand from the products that became relatively more expensive (WINE and OTHER FERMENTED BEVERAGES) to the ones that have become relatively cheaper (BEER, ETHYL ALCOHOL, and INTERMEDIATE PRODUCTS). The extent of this cross-product substitution is uncertain but given the different cross-elasticities provided in the literature and uncertainty around their robustness we expect such effects to be small.

As a result of S4a the following impacts are expected:

Clarity: improves clarity in classification criteria for RTDs and Cream Liqueurs, although the recent Siebrand judgement has also provided some guidelines for distinction that reduce the potential for overlapping of classification categories.

Prices: no significant differences in prices before and after the policy for RTDs and Cream Liqueurs.

Tax treatment: For products currently taxed as OTHER FERMENTED or as INTERMEDIATE PRODUCTS, unitary taxation implies that drinks "closer" to spirituous beverages (in terms of alcohol content or other characteristics) will also have more similar duty rates. For products already taxed as ETHYL ALCOHOL, the unitary equivalent to the duty rate on INTERMEDIATE PRODUCTS is lower than the current duty charged.

As a result of S6 the following impacts are expected:

Clarity: simplifies the current taxation structures.

Tax treatment: eliminates the possibility of using duty rates to favour certain products with low alcoholic strength which may be produced domestically. This could encourage production and consumption of higher strength products, with possible negative effects on health in society.

Prices: this option increases the duty rates and prices currently used by some countries (DE, FI, SE, UK).

Revenues: increases duty revenues collected.

As a result of S1 the following impacts are expected:

Clarity: not extra clarity to the classification criteria as there are no significant problems at the moment in differentiating sparkling from still beverages, although there may be reasons why the distinction is not valid, such as whether the products are drunk on similar occasions or whether the distinction (based on pressure and packaging) is arbitrary, both issues raised in COM(2004) 223 final.
Prices: no significant differences in prices before and after the policy.

Tax treatment: eliminates different tax treatments of similar beverages.
Reduces the possibility of tax discrimination on imports.

1.8 Options for further consideration

Our analysis suggests there are reasons to believe that the existing arrangements for classification and minimum rates cause distortions that affect the single market. However, the scope over which these distortions currently hold sway is limited, with other factors playing a much more prominent role. Nevertheless, the development of new production techniques means that the distortions caused by ambiguities in classification could

potentially become more widespread in the future. It would be possible to adapt the existing arrangements to better serve the single market, some suggestions for which we provide below.

We focus our thoughts on two objectives:

- clarifying the classification rules; and
- reducing disparity in Member States' duty rates.

For each of these, we consider each product category in turn.

Clarifying the classification rules

We believe that new rules could be introduced to complement the definitions being used for classifying the products. The new rules should be based on specific and measurable criteria. Attributes such as the alcohol content seem particularly appealing and are being used in our recommendations.

CLEANED-UP AND ADDED ALCOHOL

Data suitable for use in this part of the analysis on the degree of penetration of cleaned-up alcohol proved impossible to obtain. Nevertheless, the majority of cleaned-up alcohol currently in the market would appear to be within RTDs (with other potential products notably being within Cream Liqueurs). Thus, the analysis of the impact of S3 (a new category for RTDs with a minimum rate equal to that of ETHYL ALCOHOL) will be close to the upper bound of the impact of a policy to re-categorise products with cleaned-up alcohol in the same way.

We are of the view that the use of such an additional category is unlikely to be high if the choice to use it were optional. We note that almost all RTDs are already classified as ETHYL ALCOHOL across the EU. Furthermore, some Member States' authorities reported that they would automatically classify a beverage into ETHYL ALCOHOL if it contained cleaned-up alcohol (perhaps subject to an additional test that the nature of the product had changed).

A new category may be of most use to those Member States (DK, FR, LU) which currently apply a uniform additional duty on RTDs irrespective of the current EC categories to which the product is classified. It is a more open question whether Member States who differentiate in their 'special taxes' between RTDs of different bases, or who currently charge duty rates that happen to fall below the minimum rate for ETHYL ALCOHOL, would make use of the proposed new category if it were optional.

We were also unable to obtain detailed data on the additions made to the drinks in our dataset, so we cannot directly analyse the effect of restricting the

policy option to only affect beverages with, say, 70%, of their alcohol content coming from added alcohol. Policy option S4a does not make any consideration of the proportion of alcohol which is added to a beverage. However, the option relates to a group of drinks approximately equivalent to all drinks with added alcohol. Therefore, it yields the upper limit of the effect that a more selective policy option might obtain.

A change in policy addressing all added alcohol is the most straightforward and clear-cut approach. Nevertheless, it might not be necessarily desirable for all products containing added alcohol to be included, since the reasons for adding alcohol and the nature of the products differ. For instance, fruit wines can be quite similar to wine of fresh grapes, but grapes ferment naturally to a higher strength than other fruits, and different fruits also ferment to different strengths. In this sense, fruit wines containing added alcohol (used to achieve the same strength as wine from fresh grapes) may not warrant a different tax treatment (FISCALIS, 2005). We are aware that the scope for different treatment mainly lies in CN 2206, which would affect an even smaller proportion of the market than the 2% market share (by volume) of all products with added alcohol.

In areas where there may be uncertainty on the categories to be used for classification purposes (in particular Cream Liqueurs and RTDs) it means that some beverages can fit into more than one category of the 5-product system. This has important implications as the duty levied on the same product may be different between Member States. As a result, producers may have an incentive to change the composition of the beverages (even if only so slightly) just to get benefit from a lower duty.

It is to be noted that during the period in which this study has been undertaken, the ECJ has ruled in the case of Siebrand (C-150/08) which illustrates the type of problems reported by Member States, as it concerned certain liqueur products to which alcohol had been added. The ECJ ruled that the products with which the case was concerned should be classified to CN 2208. Moreover, it also lays down an indication of the type of tests that should be applied when determining classification.

BEER

Although it has been reported that there are occasionally individual cases where beers contain some element of added alcohol and this is becoming more of an issue as novelty flavoured beers are introduced in the market, at the present time there are no major problems in the classification of products from this category.

Nevertheless, if the essential character of the product is to be the defining factor, a clear indication of the upper limit of alcohol content allowed for this category would be helpful in foreclosing on any future classification

ambiguities. Another consideration might be to limit the amount of added alcohol or cleaned-up alcohol allowed in a product for it to qualify as BEER. However, bearing in mind the difficulties of identifying and testing such criteria, this may not improve transparency in the system.

We suggest considering:

Provide an upper bound on the maximum alcohol content of BEER beverages (for example, 12% abv).

ETHYL ALCOHOL

ETHYL ALCOHOL is a category constituted of very different types of beverages. Although they generally share a common attribute of “distilled alcohol content”, at the moment there is no lower band on the contents of alcohol of the beverages under this category. As a result it is possible to classify RTDs (which are typically low-strength products) in this category.

We have estimated in our policy options analysis that in most Member States, there would be only a small reduction in duty revenue as a result of re-categorising low-strength ETHYL ALCOHOL as INTERMEDIATE PRODUCTS.

Some considerations should be made in relation to this. Firstly, although the strengths of the drinks are different, the manner in which they are consumed may not be.

Essentially, if, say, RTDs are closer substitutes with spirits than with any other beverage (such as, for example, beer or cider), then it is appropriate to levy a duty similar to spirits, and vice versa. A similar consideration could be made for other low-strength drinks, particularly Cream Liqueurs.

However, there may be reasons to think that RTDs are not close substitutes for any other drink and so charge a different duty rate, for health or societal reasons. Indeed, the current practice in some Member States of a supplementary additional duty being levied on RTDs does exactly this.

Consequently, it can be seen that there are arguments for and against setting a lower bound to the ETHYL ALCOHOL category but, in our opinion, low-strength drinks should be treated differently to high-strength ones.

We suggest considering:

Define ETHYL ALCOHOL beverages as any alcohol beverage with alcohol content above 22%.

WINE

At present the minimum rate for WINE is zero. In practice this means a huge disparity between the duties used in different Member States. It also creates a disadvantage between beverage categories as, on a given unit of alcohol, the tax burden is very different across beverages. A minimum rate for WINE would remove some of the competitive advantage that its absence has given wine producers over beer producers in certain Member States.

One first possibility would be to introduce a rate that is equivalent to the rate being charged per unit of alcohol for another beverage (e.g. BEER). We have also analysed the option of introducing a minimum rate equivalent of the rate being charged in a wine-producing country (we took France as an example).

The results of using a BEER-equivalent minimum rate show a significant increase in the prices such that the disparity across countries is reduced. The impact on WINE prices of using the FR-equivalent rate is very small and does not help reduce the disparity across countries. Finally, the effect of using revalorising the (BEER-equivalent) minimum rate, to account for 1992 inflation, is small.

However, if the BEER-equivalent rate was to be used, wine producers would be at a disadvantage compared with the status quo. This suggests that there may be some effect on employment in the sector.

We suggest considering:

Introduce a minimum rate for WINE products. The rate could be taken to be equivalent (in alcohol terms) to the rate being used for BEER products.

OTHER FERMENTED

Following from Directive 92/83/EEC, OTHER FERMENTED BEVERAGES are defined as those products, not falling as BEER and WINE, classified to CN 2204, CN 2205 and CN 2206 and with alcohol content that is between 1.2% and 10% abv or between 10%-15% abv provided that the alcohol is entirely fermented.

At present, Directive 92/83/EEC also allows Member States to treat as INTERMEDIATE PRODUCTS fermented beverages with more than 5.5% abv if the alcohol is not entirely of fermented origin. Therefore, the fermented origin is a criterion used to differentiate the classification of products between 5.5% and 15% abv between categories of OTHER FERMENTED or INTERMEDIATE PRODUCTS.

However, due to the availability of new production techniques, the fermented origin criterion may no longer be a solid criterion for differentiating between these two categories. As seen, the use of new technologies allows for the possibility of obtaining stronger drinks whilst still using bases of a fermented origin, such as by adding cleaned-up alcohol or using reverse osmosis fortification.

Therefore, we suggest that the definition should be reconsidered to help delimit the two categories. One way would be to restrict the classification of OTHER FERMENTED only to drinks in which alcohol is obtained solely from the fermentation process (avoiding the use of cleaned-up alcohol) and with alcohol concentration which results naturally from the fermentation process (avoiding fortification using reverse osmosis techniques). Hence, drinks using cleaned-up alcohol, reverse osmosis or fortification would always fall outside of the OTHER FERMENTED beverage category.

Based on the information we received, we do not expect this to pose particular problems for the sector, with respect to cider and fruit wines, which are traditionally thought of as OTHER FERMENTED beverages. Overall, the sector is small in relation to the whole alcohol market, so there would be little effect on total duty receipts.

Specifically in the sector, the use of cleaned-up alcohol is forbidden in the production of cider and perry across much of the EU (due to an AICV agreement) and chaptalisation is the most common form of increasing alcoholic strength in such beverages. For fruit wines, we are aware of the use of distilled alcohol in the production of fruit wine in FI, and more widely, though alcohol may be cleaned up for purposes of stability, it is not used as an alternative to distilled alcohol in the production process.

Finally, as in the case of wine, the minimum rate for OTHER FERMENTED beverages is zero and this means a huge disparity between the duties used in different Member States. The results of our analysis indicate that increasing the minimum rates will have a modest impact in reducing the disparity of duty rates, and it will mainly increase the prices in ES, SK and CZ to bring them closer to the EU average.

We suggest considering:

Modify the definition for OTHER FERMENTED BEVERAGES to include:

All products (between 1.2% and 15% abv) classified to CN 2204, CN 2205 and CN 2206 not falling as BEER or WINE, provided that

- **All alcohol has been obtained from the fermentation process only**

AND

- **With alcohol concentration that has resulted naturally from the fermentation process.**

Introduce a minimum rate for OTHER FERMENTED products. The rate could be taken to be equivalent (in alcohol terms) to the rate being used for BEER products.

INTERMEDIATE PRODUCTS

We consider INTERMEDIATE PRODUCTS is a category that has room to incorporate beverages for which there are discrepancies across Member States on the classification systems.

Following from Directive 92/83/EEC, INTERMEDIATE PRODUCTS are defined as all products (between 1.2% and 22% abv) classified to CN 2204, CN 2205 and CN 2206, which do not fall under BEER, WINE and OTHER FERMENTED BEVERAGE categories. Using the new definitions of BEER, WINE and OTHER FERMENTED BEVERAGE and the lower bound for the ETHYL ALCOHOL category suggested in these conclusions would make the classification clearer. Under this new definition, RTDs, fortified wines, liqueurs, etc., (all under 22%) would fall in the INTERMEDIATE PRODUCTS category. This may not be desirable for all Member States, for traditional or political reasons. Although this will provide clarity, previous concerns about lack of clarity may have been lessened by the ruling in the Siebrand case.

Since this category would contain beverages of very different alcohol strengths, ranging from 1.2% to 22%, duties would be better levied per unit of alcohol.

We have analysed the policy option of doing this, using the unitary equivalent of the current minimum rate for INTERMEDIATE products and setting actual rates to be approximately revenue neutral. We found that prices will barely fall in most Member States (under 2%), with the exception in PL (where prices would fall 7%).

This policy option would help clarify the classification system with only small changes to market prices and duty revenues. Thus, there seem unlikely to be major effects on affordability for consumers, or substitution away from existing consumption patterns. By retaining revenue neutrality, duties on

other products would not need to be changed in response to this policy option.

We have also considered the option of taxation under bands of three degrees of alcohol but would recommend against it as it is possible that this would result in operators changing the strengths of their beverages to benefit from lower duties only.

We suggest considering:

Provide a definition for INTERMEDIATE PRODUCTS along the following lines:

INTERMEDIATE PRODUCTS - All products (between 1.2% and 22% abv) classified to chapter 22 of the nomenclature which do not fall under BEER, WINE and OTHER FERMENTED BEVERAGES categories;

Taxation of INTERMEDIATE PRODUCTS based on units of alcohol.

Reduce disparity in duty rates

We believe increasing the minimum rates is the obvious tool.

Minimum rates have been losing value in real terms from when they were originally set in 1992. Our analysis has shown that updating the minimum duty rates will have minimal impact on the prices of most products and on most duty revenues collected by Member States.

For all products we suggest considering:

Update minimum rates for all products to account for the inflation that has taken place since 1992.

The current framework allows different rates for sparkling and still products. This leads to a reduction in duty disparity across some borders (where one country levies a higher rate on sparkling products and its neighbour does not, even though they levy similar rates on corresponding still products) and would help reduce the range of rules and options under which drinks are being taxed.

The consideration is supported by a previous Commission paper (COM(2004) 223 final), which gave reasons why the distinction is not valid, such as

whether the products are drunk on similar occasions or whether the distinction (based on pressure and packaging) is arbitrary.

We suggest considering:

Remove different tax treatment for still and sparkling products.

Under the current framework reduced duty rates for low-strength products are possible. We would recommend abolishing such differences as it will simplify the tax system and make it more transparent to operators.

The products affected fall in OTHER FERMENTED (below 8.5% abv) and INTERMEDIATE PRODUCTS (below 15% abv), primarily being ciders and perries, and low-strength punches and creams. We do not have estimates for BEER (below 2.8% abv), WINE (below 8.5% abv), or ETHYL ALCOHOL (below 10% abv) as our underlying dataset does not contain any such observations, though it should be noted that all Member States charge their standard rates on ETHYL ALCOHOL products exceeding 2.8% abv.

Whilst total duty revenues are not substantially affected, there are some substantial price rises in the Member States with high standard rates, which suggests that producers of affected products would lose some competitiveness against producers of other products and suggests a substantial decrease in affordability for consumers of those products.

This policy option may encourage movement away from lower-strength drinks, which may then have health implications, though the extent of this may be small given that cross-price demand appears in general to be inelastic. It is important to note that the policy option would not affect small producers, but it may have an effect on some other producers' competitiveness. Another point to note is that this policy option is more suitable in combination with a shift to levying duties on a unitary basis. In the absence of this, the use of reduced rates for low-strength beverages does act as an optional banding system which approximates unitary rates. If a non-zero minimum rate were to be introduced for WINE and OTHER FERMENTED, it may be desirable to specify a rule for the reduced rate, such as that for INTERMEDIATE PRODUCTS, which sets the minimum rate on low-strength drinks to be no less than 60% of the prevailing standard rate.

We suggest considering:

Remove different tax treatment for reduced-strength products.

It is not clear that the disparity in prices across the EU will be reduced significantly by only increasing the minimum rates. This is because this measure will only affect a small number of countries and it will not reduce significantly the disparity between, collectively, the four Member States charging the highest duties, and the others.

In order to reduce the price differences we believe that, in addition to minimum duty rates, there could be a maximum rate. Both rates would act as a ceiling and floor in setting the duties by Member States, and could be defined to be a certain percentage from the EU average duty rate for each product. If a maximum rate is set in absolute nominal terms, this will need to be revalorised on, perhaps, an annual basis to avoid eroding the real maximum duty rate over time.

Over time, this measure would help to achieve a real EU-convergence in the duty rates and in prices.

It is questionable, though, of the extent to which a binding ceiling could be set for the maximum rate. Existing duty rates have been arrived at for a series of reasons, including Exchequer revenue-raising and for health and societal reasons. Member States may be unwilling to lose their flexibility to set higher rates or undertake a reduction in the standard rates to fall within any proposed maximum.

We suggest considering:

As well as a minimum rate, introduce a maximum duty rate.