

EU EXCISE FRAMEWORK FOR THE NEW NON-COMBUSTIBLE PRODUCTS AND IMPLICATIONS FOR THEIR TAXATION IN BULGARIA

FACTORS DRIVING THE MARKET GROWTH OF THE NEW NON-COMBUSTIBLE PRODUCTS AS AN ALTERNATIVE TO CONVENTIONAL CIGARETTES AND OTHER COMBUSTIBLE TOBACCO PRODUCTS AND IMPACT OF THE EXCISE FRAMEWORK ON REDUCING SMOKING PREVALENCE

The Report is an adapted version of the in-depth study conducted by IME in partnership with The European House-Ambrosetti on the factors driving the new heated tobacco products (HTP) penetration on different markets and the excise framework for these new products in the EU Member States entitled „HTPs Excise Framework in the EU and tax-induced substitution across tobacco products” and published in 2022.

The Report was commissioned by Philip Morris Bulgaria EOOD for the purpose of examining the overall context in Bulgaria in relation to the changed excise rates for all tobacco products and the introduction of excise duties on nicotine-containing e-liquids in Bulgaria adopted in 2022 in the form of a 4-year tax calendar, and provides expert recommendations on the further development of the excise framework in view of the forthcoming revision of Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco, particularly regarding the new non-combustible products.

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Introduction

In recent years IME in partnership with The European House-Ambrosetti has conducted an in-depth study of the commercialization and treatment of heated tobacco products (HTPs) comprising the new non-combustible products category in Europe. IME's Report on the heated tobacco products (HTPs) "HTPs Excise Framework in the EU and tax-induced substitution across tobacco products" (2022), published on the [website](#) of the Think Tank Platform Initiative, explores the factors driving HTPs penetration on different markets and examines the excise framework in each Member State in the European Union. The Report puts the debate on the tax treatment of HTPs in European context and is part of the broader debate related to the forthcoming revision of Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco.

The subject of the Report is especially relevant to Bulgaria not only in view of the forthcoming revision of the European Directive, but also in view of the debates in 2018 and 2022 on the taxation of the new non-combustible tobacco and nicotine products vs the combustible tobacco products for smoking (more specifically cigarettes). At the end of 2022, amendments to the Excise Duties and Tax Warehouses Act, establishing a new excise calendar for the 2023-2026 period – setting forth stepped increases of all tobacco excise duties and introducing excise duties on the nicotine-containing e-liquids, were adopted at the proposal of the Ministry of Finance. In 2023, additional changes were enacted that 1) taxed all e-liquids with equal excise regardless of whether they contained nicotine and 2) introduced a new excise duty for nicotine-containing tobacco substitutes. In practice this means that in the next four years, excise duties on all tobacco and nicotine products in Bulgaria will increase. A key aspect of the latest amendments is the treatment of the "non-combustible products".

HTPs have been available on the Bulgarian market for about five years and the excise framework for them was adopted on 4th August 2017 and entered into force on 1st January 2018. The initial excise rate of BGN 152 per one kg tobacco was changed on 1st October 2018, less than one fiscal year later, to BGN 233 per one kg tobacco. The new amendments to the law from the end of 2022 provide for a major increase of the excise on HTPs in the coming years with the rate going up to BGN 233 per kg in 2022 and reaching BGN 400 per kg in 2026. This increase is significantly bigger than the planned increase of cigarette excise meaning that the excise differential between the two categories will narrow gradually which may be expected to bring about changes in the behaviour of both the companies and the consumers.

The amendments to the excise duties law from 2022 and 2023 established a new excise framework for e-liquids, regardless if they contain nicotine or not. Previously, e-cigarettes were not taxed, although they have been available on the Bulgarian market for many years. According to the amendments e-liquids, regardless if they contain nicotine or not, are now considered tobacco products for the purposes of the law and are subject to excise duty – starting at BGN 0.30 per millilitre in 2023 and reaching BGN 0.45 per millilitre in 2026. E-liquids do not contain tobacco and in this sense they are "classified" as tobacco products only for the purposes of the Excise Duties and Tax Warehouses Act, but not for the purposes of the Act on Tobacco and on Tobacco and Related Products where such products are included in the group of related products.

At first, only nicotine-containing e-liquids were included in the excise law in Bulgaria, but with the latest amendments the excise framework covers all e-cigarettes, regardless if they contain nicotine or not. The general trend in Europe is towards a gradual increase of the number of countries that levy taxes on e-cigarettes. The taxation approaches vary, and most of EU countries, where e-cigarettes are

excised, apply the same excise rate on all e-cigarettes independent of whether they contain nicotine or not, while others opt for higher rates or focus only on the nicotine-containing e-cigarettes.

As the amendments from 2022 and 2023 demonstrate, the taxation of non-combustible and nicotine products, more specifically HTPs and e-cigarettes, is a relevant subject in Bulgaria. At this time the excise framework for the non-combustible and nicotine products is entirely within the competences of Bulgaria, but common definitions and taxation rules for such products similar to the taxation rules for cigarettes and other combustible tobacco products for smoking are expected to be introduced with the revision of the EU Tobacco Excise Directive. This calls for exploring and analysing the European experience in the taxation of non-combustible products and for examining the impact of the excise framework on consumer behaviour.

The latest changes in the excise calendar demonstrate that the topic of taxation of new non-combustible products in Bulgaria is relevant. For a couple of years three new products came up in relation to the issue of taxing tobacco and related products – HTPs, e-cigarettes, and nicotine-containing tobacco substitutes – all of them falling into the category of "non-combustible products". In fact, these products form part of the total nicotine market in Bulgaria. In this Report we examine in detail the implementation of the established excise framework for the new non-combustible products in Europe with the aim of outlining a clear path for their taxation in Bulgaria.

Commercialization of heated tobacco products in Europe

The market for heated tobacco products (HTPs) has grown rapidly in the past years. According to estimates of one of the leading companies developing and marketing HTPs, Philip Morris International (PMI)¹, the global sales volumes of their HTPs (sold under the brand HEETS) intended to be used with the tobacco heating device IQOS reached about 95 billion sticks in 2021 and more than 109 billion sticks in 2022.² At the end of 2022, the IQOS users worldwide amounted to 24.9 million and 71% of them have switched fully to the new products and abandoned cigarette smoking³. Europe is the most dynamic market for the new products with the sales volumes in wider Europe amounting to 64 billion sticks in 2022, and 39.5 billion sticks in the European Union (EU). The detailed data of PMI, including breakdowns by country, allow for an in-depth evaluation of the commercialisation of the new products in the EU.

Table 1: Intra-Community supplies and import of PMI HTPs globally (million sticks, 2016-2022)

| <i>M sticks</i> | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|--|--------------|---------------|---------------|---------------|---------------|---------------|----------------|
| Supplies of PMI heated tobacco products | 7 394 | 36 226 | 41 392 | 59 652 | 76 111 | 94 976 | 109 169 |
| European Union | 224 | 1 889 | 5 997 | 12 569 | 19 842 | 28 208 | 39 515 |
| <i>Germany</i> | - | 100 | 400 | 900 | 1 600 | 2 300 | 3 400 |
| <i>Italy</i> | 100 | 700 | 1 700 | 3 500 | 5 600 | 8 900 | 12 300 |
| <i>Poland</i> | - | 100 | 400 | 1 100 | 2 400 | 3 100 | 4 500 |
| <i>Spain</i> | - | 100 | 200 | 300 | 400 | 500 | 900 |
| Eastern Europe | 64 | 674 | 4 979 | 13 453 | 20 898 | 25 650 | 24 806 |
| <i>Russia</i> | 100 | 300 | 3 400 | 9 200 | 13 600 | 16 300 | 15 400 |
| Middle East & Africa | 36 | 907 | 3 403 | 2 654 | 1 022 | 2 140 | 4 456 |
| South & Southeastern Asia | - | - | - | - | 36 | 240 | 469 |
| East Asia & Australia | 7 070 | 32 729 | 26 866 | 30 677 | 33 862 | 38 162 | 39 391 |
| Latin America & Canada | - | 27 | 147 | 299 | 451 | 576 | 532 |

Source: Annual reports of Philip Morris International (PMI) for 2018 and 2021.

British American Tobacco (BAT) is the other large manufacturer of HTPs in the world⁴. The global sales volumes of their HTPs⁵ sold under different brands (Neo, Dunhill) and used with the tobacco heating device Glo reached 19 billion sticks in 2021, with 9.8 billion sticks sold in wider Europe and North Africa. In 2022 global sales volumes of HTPs by BAT reached 24 billion sticks, with 13 billion sticks sold in Europe and North Africa. Taking into account the key heated tobacco markets of the company as detailed data is not publicly available, the BAT market share for HTPs within the EU for 2021 can be estimated to be in the 10-15% range.

¹ See Виж PMI's heated tobacco products ([here](#))

² See PMI's annual reports for the period 2017-2022 ([here](#))

³ See [Quarterly earnings announcements – Q1 2023](#) (PMI)

⁴ See BAT's tobacco heating products [here](#)

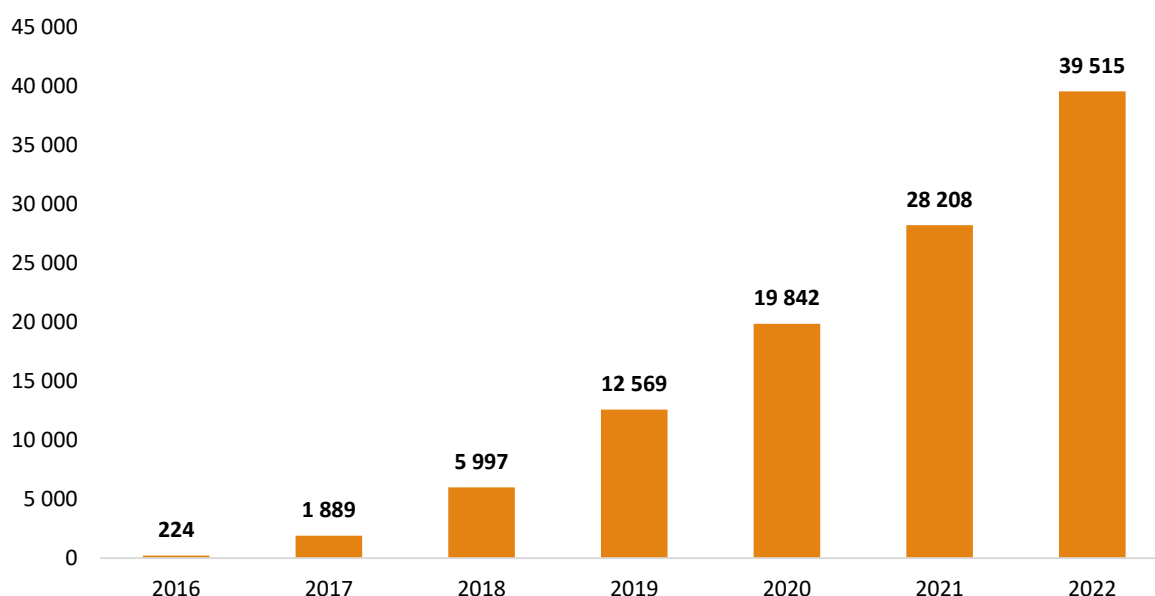
⁵ See BAT's annual reports for 2021 and 2022 ([here](#))

Imperial Tobacco are also entering the market, reporting successful pilot projects in Czech Republic and Greece and later in 2022 in Italy, Portugal, Hungary and more recently in 2023 in Bulgaria, offering HTPs with the ID brand to be used with the tobacco heating device PULZE⁶.

The early market entry of the PMI heated products and their solid share in the category in the EU, including Bulgaria, warrants using the detailed data of the company to explore the main factors driving the commercialisation of the new products. Below we present data about the evolution of PMI HTPs by region focusing on the European market as the most dynamic market for the new products globally.

HTPs have a relative short commercial history in Europe. The innovative products were first launched on the market in Japan in 2014 and Japan remains to this day the biggest HTPs market. The new products were introduced on some markets in Europe in 2016 and in 2017 they became widely available across different European markets. PMI data shows that the sales volumes in the EU grew from only 224 million sticks in 2016 to 1 889 million sticks in 2017, 5 997 million sticks in 2018 and 12 569 million in 2019. The sales volumes in the EU reached 19 842 million sticks in 2020 and 28 208 million sticks in 2021. The solid growth of the new products continued in 2022 with the sales reaching 39 515 million sticks in the EU.

Figure 1: Intra-Community supplies of PMI HTPs in the EU (million sticks, 2016-2022)



Source: Annual reports of Philip Morris International (PMI) for 2017-2022.

In the past 3-4 years Europe has definitely been the most dynamic market for innovative products. The sales volumes of PMI within the EU increased as a share of the global HTPs market of the company by 5% in 2017 reaching 30% in 2021 and 36% in 2022. The share also went up in Eastern Europe, including Russia, and reached 27% of the global consumption in 2021, but this changed in 2022. The European markets overall account for more than a half (59%) of the global sales of PMI HTPs and this share doubled in the period 2018-2022. This is an important finding as it puts the debate on the excise taxation of innovative tobacco products in the EU and Bulgaria, in particular, in context.

⁶ See next generation products by Imperial Brands [here](#)

The market share of PMI HTPs in the EU increased from 3.9% in the first quarter of 2020 to 6.4% in the fourth quarter of 2021 and more than 7% in 2022⁷. HTPs market share is defined as the total sales of PMI HTPs as a percentage of the total estimated sales for cigarettes and HTPs on the market. The development and commercialisation of the new products in the EU Member States however take place at a different pace with the market shares varying from 1% in some countries to above 20% in others. It is important to assess the factors that drive the success of HTPs in some countries because these factors are likely to be very relevant in the discussion on the excise policy on the new products in Europe, including their potential inclusion in the Excise Directive and hence the formulation of a common taxation approach at EU level.

In Bulgaria, specifically, HTPs became available in 2017 and a separate excise category was established for them in 2018. The consumption of the new products measured in taxed tobacco quantities rapidly grew to 140 tons in 2018 with the growth rate slowing down in the next two years and reaching 240 tons in 2020⁸. There was a slight decline in 2021 to 193 tons of taxed tobacco which has been estimated by the authors of this report into app. 4% market share of the tobacco market in Bulgaria. An increase of excised volume was reported in 2022 with the taxed tobacco reaching 300 tons. The 2022 data show that the estimated market share of the new products in Bulgaria has increased to app. 6% of the total tobacco market⁹.

HTPs market share in the EU Member States

Determining the market share of HTPs in the EU Member States is key for examining the factors that contribute to the more successful commercialisation of the new products on some markets and for assessing the impact of the excise policy on their market penetration. The best method of determining the market share of HTPs is to measure the consumption of new products against the total nicotine market, including cigarettes, roll-your-own tobacco, other traditional products, HTPs, e-cigarettes, etc. As there is no available detailed data about the total nicotine market, in this Report we use the most recent estimates of the tobacco market by Philip Morris International (Annex I).

In most EU countries the new products were launched in 2017¹⁰. From this perspective the 2021 data provide a clear picture of the differences in terms of the HTPs uptake in the different countries. In our assessment we take into consideration the year when the new products were launched, separating the countries where HTPs were launched after 2020 into a distinct category. Based on PMI's detailed estimates of the market share of the HTPs, the markets in Europe can be divided into the following groups:

- ✓ The first group is comprised of the countries where the HTPs market share was more than 10% in 2021. These are Lithuania, Hungary, Greece, Slovakia, Portugal, Czech Republic, Italy, and Latvia. We labelled this group "leading HTPs markets" in Europe where the new products now play a significant role on the total tobacco market;
- ✓ The second group is comprised of the countries where the HTPs market share was in the 2-10% range at the end of 2021. These are Slovenia, Poland, Croatia, Bulgaria, Romania, and Germany. We labelled this group "developing HTPs markets" where the new products are

⁷ See [Quarterly earnings announcements – Q4 2022](#) (PMI)

⁸ See National Customs Agency (Bulgaria) annual reports ([here](#))

⁹ IME calculations based on official data from the National Customs Agency for cigarettes and HTPs volumes

¹⁰ The first launch of PMI's HTPs in Europe was in Milan (Italy) in 2015. However, 2017 was the year when HTPs were introduced widely across Europe.

known on the market, have shown dynamic growth in the past years and a potential to reach a 10% market share in the next few years;

- ✓ The third group is comprised of the countries where the HTPs market share was less than 2% at the end of 2021. These are the UK, Spain, Netherlands, Denmark, France, Cyprus, and Sweden. We labelled this group "catching up HTPs markets" where the new products have already been made available (before 2020) but their market share is still very low;
- ✓ In addition to the first three groups, attention should also be paid to the countries where 1) HTPs were launched on the market after 2020 and their market share is still very low, and the countries where 2) the new products have not been introduced on the market although some use of such products brought in from other countries is reported. These countries include: 1) Austria and Estonia – HTPs were introduced on the market after 2020 and their market share is quite low; and 2) Belgium, Finland, Ireland, Luxembourg, and Malta – HTPs have not been introduced on the market yet.

This type of categorization of the EU Member States makes it possible to examine the different factors driving the market growth of the new products. The factors that differentiate the leading and the developing markets (groups one and two) from the catching up markets (group three) form the understanding of the different dynamics of HTPs penetration as it relates to the excise duties levied on them.

Factors influencing the HTPs market penetration in the EU Member States

We will consider several factors that may influence the market penetration and the switching from cigarettes or other products for smoking to HTPs in different markets. Such factors are the tobacco use rates, specifically cigarette smoking rates, the smokers' habits, the excise framework in place and the excise differential, the price differences between the various tobacco products, the affordability of the heated products and the potential regulatory barriers to the new products. Additional comments and observations are provided with regards to consumer behaviour in relation to HTPs.

Firstly, we will examine some key data on smoking in the different countries and more specifically two indicators – share of smokers overall, including share of smokers who have never attempted to quit. Data from Eurobarometer¹¹ from 2017, i.e., the year when HTPs were introduced widely across the European markets, are used. The working hypothesis is that the higher share of smokers is a positive contributing factor for the market penetration of the new products given that in accordance with multiple studies and data¹² the current smokers are the potential HTPs users, meaning that HTPs are a smoke-free alternative to the traditional products for smoking.

Next, we will review the excise differentiation and the price levels of HTPs and the traditional tobacco products. Both are important because the price levels can change consumer behaviour with regards to the new products, and the excise differential provides an incentive for the companies to be proactive and for the smokers to switch to using HTPs. The affordability of these products will also be addressed as it is important to see whether there are differences between the countries where tobacco products are affordable and the countries where they are not. The affordability dynamic will

¹¹ See [Attitudes of Europeans towards tobacco and electronic cigarettes](#), Eurobarometer (2018)

¹²This finding was supported in different studies with HTPs users. See studies with users in Hong Kong ([here](#)), Japan ([here](#)) and Greece ([here](#)). These studies demonstrate that HTP users are predominantly current or former smokers most of whom have stopped smoking.

also be considered, especially in the lower income countries where it may impact the acceptance of the new products as an alternative.

The various regulations of the tobacco products should also be considered because the restrictions on advertising and promotion may have a considerable impact on the market penetration of the new products. On account of their specificities such as the fact that they are used with technological electronic devices which require an initial investment from the users, as well as after-sale services, HTPs are marketed differently than the traditional products meaning that the regulation of their advertising, promotion and consumer engagement plays an important role for the potential acceptance of HTPs by smokers of traditional products. The characteristics of the new products are such that consumer engagement and the application of different retail practices are key for both the better understanding of this new product category, and the acceptance of the products by the smokers of traditional products for smoking and their subsequent switching.

Why are some markets more successful than others?

To assess the impact of different factors on the market penetration of HTPs in various countries we will use the categorization of countries based on the market share of HTPs – leading markets, developing markets, catching up markets and lastly markets, where the market share of heated products is low or where such products are not available. This categorisation allows us to highlight the factors that play a significant role for the market penetration of the new products.

Share and habits of the smokers

The analysis in this section is based on data about the smoking rates in 2017, as this is the year when HTPs were introduced widely across the European markets. Using the Eurobarometer¹³ data we can divide the countries based on the overall share of smokers – less than 20% ("low"), from 20 to 25% ("medium"), from 25 to 30% ("medium high") and more than 30% ("high"), and based on the share of smokers who have never attempted to quit – less than 10% ("low"), between 10 and 15% ("medium"), from 15 to 20% ("medium high") and more than 20% ("very high").

The data clearly show that the countries with high overall shares of smokers and high shares of smokers who have never attempted to quit, marked in green in the table, report higher market shares of HTPs, i.e. the new products penetrate the market more rapidly and are perceived by the smokers as an alternative to the conventional tobacco products. In almost all countries where the market share of HTPs is low or where such products are not available on the market the overall share of smokers and the share of smokers who have never attempted to quit is very low – most often less than 10% of the population.

Table 2: Share and habits of the smokers by type of HTPs market

| Country (year of IQOS launch) | Share of smokers (% , 2017) | Share of smokers who have never attempted to quit (% , 2017) |
|---|-----------------------------|--|
| High market share of HTPs (≥10%) / leading markets | | |
| Lithuania (2017) | medium high (25-30%) | medium (10-15%) |
| Hungary (2019) | medium high (25-30%) | high (15-20%) |
| Greece (2016) | high (>30%) | high (15-20%) |
| Slovakia (2017) | medium high (25-30%) | medium (10-15%) |

¹³ See [Attitudes of Europeans towards tobacco and electronic cigarettes](#), Eurobarometer (2018)

| | | |
|---|----------------------|------------------|
| Portugal (2015) | medium high (25-30%) | high (15-20%) |
| Czech Republic (2017) | medium high (25-30%) | high (15-20%) |
| Italy (2015) | среден (20-25%) | high (15-20%) |
| Latvia (2018) | high (>30%) | low (<10%) |
| Medium market share of HTPs (2-10%) / developing markets | | |
| Slovenia (2017) | medium high (25-30%) | medium (10-15%) |
| Poland (2017) | high (>30%) | high (15-20%) |
| Croatia (2017) | high (>30%) | high (15-20%) |
| Bulgaria (2017) | high (>30%) | very high (>25%) |
| Romania (2015) | medium high (25-30%) | high (15-20%) |
| Germany (2016) | medium (20-25%) | medium (10-15%) |
| Low market share of HTPs (<2%) / catching up markets | | |
| UK (2016) | low (<20%) | low (<10%) |
| Spain (2016) | medium high (25-30%) | medium (10-15%) |
| Netherlands (2016) | low (<20%) | low (<10%) |
| Denmark (2016) | low (<20%) | low (<10%) |
| France (2017) | high (>30%) | medium (10-15%) |
| Cyprus (2017) | medium high (25-30%) | medium (10-15%) |
| Sweden (2019) | low (<20%) | low (<10%) |
| Late introduction (after 2020) and low share of HTPs | | |
| Austria (2020) | medium high (25-30%) | high (15-20%) |
| Estonia (2020) | medium (20-25%) | low (<10%) |
| HTPs are not available on the market (data as of 2021) | | |
| Finland | low (<20%) | low (<10%) |
| Belgium | low (<20%) | low (<10%) |
| Ireland | low (<20%) | low (<10%) |
| Luxembourg | medium (20-25%) | low (<10%) |
| Malta | medium (20-25%) | low (<10%) |

Source: IME based on PMI reports (2021) & Eurobarometer (2017)

The leading markets for HTPs have the highest share of smokers (more than 25% or even 30%) and high share of smokers who have never attempted to quit (in most it is more than 15%). The developing HTPs markets have similar characteristics – high shares of smokers overall and of smokers who have never attempted to quit. Bulgaria also falls within this group and is at the top of the list for both indicators – more than 30% smokers overall most of whom have never attempted to quit. Based on these indicators Bulgaria should be an even more suitable market for the new non-combustible alternatives and the fact that it is not among the leading markets can be explained with other analysed factors – the excise framework and the differential excise treatment of heated tobacco and conventional cigarettes.

Looking at the various tobacco products in more detail shows that the share of HTPs is also low in countries with high share of other tobacco products – tobacco for smoking for instance. Countries such as Germany, France, Netherlands, and the UK for example have a very high share of tobacco for smoking and relatively low share of heated tobacco. The market share of tobacco for smoking in these countries varies from 15-20% to almost 40% of the total tobacco market. Other markets with traditionally high share of tobacco for smoking are Belgium and Luxembourg and HTPs have not yet been made available on the market in both these countries. The total tobacco, or rather nicotine market, in Sweden is a very interesting case as this is the only EU Member State where the sale of snus

is allowed and where snus is predominantly used. Snus is a non-combustible tobacco product made of ground oral tobacco in pouches and is one of the products in the non-combustible category – a smoke free alternative to conventional smoking. The smoking rate in Sweden is the lowest in the EU countries as a logical consequence of the dominating market share of snus¹⁴.

It should be noted that the prices of tobacco for smoking in the countries with high market shares of roll-your-own tobacco are relatively lower than the prices of other tobacco products which makes it more affordable compared to heated tobacco.

Cigarettes dominate the market in most countries in the leading and developing market groups, while the consumption of traditional tobacco products for smoking is relatively low – in most cases the market share of tobacco for smoking is less than 5% of the total tobacco market. HTPs are an attractive alternative to cigarettes in these markets, especially if an adequate excise framework for them is put in place making their prices competitive with cigarette prices.

Excise and price differential

The excise framework for HTPs differs from that for cigarettes in all EU Member States. Whereas the excise rates for cigarettes are harmonised and applied based on numbers of sticks while including an ad valorem component which depends on the price of cigarettes, a separate excise category was created for the HTPs with a different tax base – weight of tobacco in the product, i.e. purely specific excise based on the tobacco weight in the product similar to that applied for the tobacco for smoking. This makes sense as HTPs are new products available in varying formats, types and sizes and used as a consumable for different technologies and heating devices, making the manufactured tobacco content by weight, e.g., kilograms, the only common denominator. To make a comparison of the excise burdens on the different combustible and non-combustible products, we adjusted the excise burden for all products for the weight of tobacco in them taking into account what they have in common.

For the analysis we use data¹⁵ for 2019 and 2021 which allows us to assess the excise framework as it evolved. HTPs are new products which explains why there were more changes to the excise framework applied to them. The data for 2019 indicate the initial approach to the taxation of the new products in the first years after their introduction on the market, while the data for 2021 also cover the changes to the initial framework and show the evolution of the taxation approach in the European countries. It is important to study the changes in the taxation of HTPs in this period, especially in the leading and developing markets, as they illustrate an already established EU practice and reveal a clear direction of the chosen excise approach in the different EU Member States with respect to a product that has become well known and plays a role in the total tobacco and nicotine market.

The data clearly show that there was excise differentiation between cigarettes and HTPs in both years under consideration, with the excise burden based on weight of tobacco in the new products being almost always lower than the excise burden on the weight of tobacco in cigarettes. In most cases the excise burden on HTPs ranges from 50 to 100% of the excise burden on cigarettes. We need to reiterate that this estimate is based on the weight of tobacco in the products and not on number of sticks. The excise burden on the new products is higher than that on cigarettes based on the weight

¹⁴ Data for the tobacco and nicotine products in Sweden is available [here](#)

¹⁵The data about the excise burden on cigarettes are taken from the [Excise Duty Tables](#) of the European Commission for 2019 and 2021. The data about the excise duties on HTPs are taken from different sources, including [Vapor Products Tax](#). The excise burden on HTPs is estimated by IME based on PMI data about the price of HEETS on different markets.

of tobacco in both products only in a small number of European countries. We grouped the countries based on the excise burden on HTPs as a percentage of the burden on cigarettes based on the quantity of tobacco in the products in the following categories – less than 65% ("low"), from 65 to 90% ("medium"), about 100% ("equivalent") and more than 100% ("high") tracing the evolution throughout the years.

To also examine the price differential between the two products we compare the price per pack of HTPs of the HEETS brand, as the best-selling HTP, and the weighted average price (WAP) per pack of cigarettes¹⁶. The difference is undoubtedly important and has a direct effect on consumer behaviour. The notes "low" or "high" indicate that the price of HTPs of the HEETS brand is either lower or higher than the weighted average price of a pack of cigarettes by up to 10%. The additional symbol "+" on the label means additional 10% price difference.

In addition to assessing the excise and price differential for HTPs vs cigarettes we also examined the affordability of tobacco products in different countries¹⁷. In this case we divided the countries in three groups based on the affordability of cigarettes calculated as the share of the price per pack of cigarettes (WAP) of the daily disposable income per capita. If the indicator is above 14%, affordability is "low" and if it is between 9 and 14%, affordability is "medium", while if it is below 9%, affordability is "high". The affordability indicator is important as it provides better understanding of the role of the excise and price differential in forming consumer behaviour. It is likely that the impact of the excise and price differential for the new products will be higher in markets with low affordability of tobacco products.

Data about all three factors discussed are presented in the table below – excise differential in 2019 and 2021, price differential in 2021 and estimated affordability of the tobacco products in the different markets while maintaining the categorization based on market share of HTPs for 2021. The data clearly show that almost always the differential is to the advantage of the new products, but they also show a somewhat surprisingly higher share of HTPs in markets where the affordability is seemingly lower.

Table 3: Excise and price differential and affordability by type of HTPs market

| Country (year of IQOS launch) | Excise burden on HTPs/cigarettes (% , 2019) | Excise burden on HTPs/cigarettes (% , 2021) | Price differential HTPs/cigarettes (% , 2021) | Estimated affordability of cigarettes (2018) |
|---|--|---|--|--|
| | Excise burden calculated based on the weight of tobacco in the product | | Price per pack of HTPs (HEETS) vs price (WAP) per pack of cigarettes | Price (WAP) per pack of cigarettes / daily disposable income |
| High market share of HTPs (≥10%) / leading markets | | | | |
| Lithuania (2017) | low (<65%) | medium (65-90%) | low (90-99%) | medium (9-14% of DY) |
| Hungary (2019) | medium (65-90%) | medium (65-90%) | high (100-110%) | low (>14% of DY) |
| Greece (2016) | medium (65-90%) | medium (65-90%) | low (90-99%) | low (>14% of DY) |
| Slovakia (2017) | low (<65%) | medium (65-90%) | high + (>110%) | medium (9-14% of DY) |
| Portugal (2015) | high (100-125%) | high (100-125%) | low (90-99%) | medium (9-14% of DY) |

¹⁶The data about the HTPs and the different cigarette brands are taken from PMI's [Investor Kit](#) for 2019 and 2021. The data about the weighted average price (WAP) of cigarettes are taken from the [Excise Duty Tables](#) of the European Commission for 2019 and 2021.

¹⁷The price affordability indicator is based on IME estimates of the price per pack of cigarettes as a percentage of the daily disposable income per capita in the EU. See [Study of the price elasticity and affordability of tobacco products in Bulgaria within the common European excise policy](#) (IME, 2018)

| | | | | |
|---|--------------------|--------------------|--------------------|----------------------|
| Czech Republic (2017) | low (<65%) | low (<65%) | high + (>110%) | medium (9-14% of DY) |
| Italy (2015) | low (<65%) | medium (65-90%) | low (90-99%) | high (<9% of DY) |
| Latvia (2018) | low (<65%) | равна (≈100%) | high (100-110%) | medium (9-14% of DY) |
| Medium market share of HTPs (2-10%) / developing markets | | | | |
| Slovenia (2017) | low (<65%) | low (<65%) | равна (≈100%) | medium (9-14% of DY) |
| Poland (2017) | low (<65%) | low (<65%) | low (90-99%) | low (>14% of DY) |
| Croatia (2017) | low (<65%) | high (100-125%) | equivalent (≈100%) | medium (9-14% of DY) |
| Bulgaria (2017) | equivalent (≈100%) | equivalent (≈100%) | high (100-110%) | low (>14% of DY) |
| Romania (2015) | low (<65%) | low (<65%) | low + (80-90%) | low (>14% of DY) |
| Germany (2016) | medium (65-90%) | medium (65-90%) | low (90-99%) | high (<9% of DY) |
| Low market share of HTPs (<2%) / catching up markets | | | | |
| UK (2016) | low (<65%) | low (<65%) | low ++ (<80%) | medium (9-14% of DY) |
| Spain (2016) | high (100-125%) | high (100-125%) | high (100-110%) | medium (9-14% of DY) |
| Netherlands (2016) | low (<65%) | low (<65%) | low + (80-90%) | high (<9% of DY) |
| Denmark (2016) | low (<65%) | low (<65%) | low + (80-90%) | high (<9% of DY) |
| France (2017) | high + (>150%) | high + (>150%) | low ++ (<80%) | medium (9-14% of DY) |
| Cyprus (2017) | medium (65-90%) | medium (65-90%) | low (90-99%) | medium (9-14% of DY) |
| Sweden (2019) | medium (65-90%) | medium (65-90%) | low + (80-90%) | high (<9% of DY) |
| Late introduction of HTPs (after 2020) and low share of HTPs | | | | |
| Austria (2020) | low (<65%) | medium (65-90%) | low (90-99%) | high (<9% of DY) |
| Estonia (2020) | low (<65%) | low (<65%) | high (100-110%) | medium (9-14% of DY) |

Source: IME estimations based on PMI Investor Kit & Excise Duty Tables, European Commission

In 19 out of a total of 23 countries, the excise burden on HTPs calculated based on the weight of tobacco in the product is lower than that on cigarettes. While in 2019 the excise burden on HTPs in most countries was less than 65% of the burden on cigarettes, in 2021 the excise burden on heated tobacco was 65-90% of that on cigarettes. All indicators point to the conclusion that after the initial introduction of the new products on the "leading" markets when the excise burden was "incentivizing", most countries opted to increase the excise rates for HTPs while preserving the "incentivizing" excise differential to the advantage of the new products.

Bulgaria is one of the very few countries where the excise burden for the two years under consideration calculated based on the weight of tobacco in the products is essentially equivalent. Despite creating a separate excise category for the new products, Bulgaria is one of the countries with relatively high excise burden on HTPs which burden was established at the very early stages of introduction of the new products. In all likelihood, this is one of the reasons for the slower growth of the new products as compared to other countries with similar characteristics – high share of smokers overall and especially of smokers who have never attempted to quit. While the lowest excise burden in the first year of the introduction of HTPs in Bulgaria led to faster market growth of the new products, the subsequent increase of the excise on HTPs in 2018, and hence the narrowing excise differential, resulted in the growth slowing down.

What the countries with high excise burden on heated tobacco vs cigarettes have in common is the temporary classification of HTPs in the tobacco for smoking category which is subject to full or partial ad valorem taxation. This is the case in France¹⁸, Spain, and Portugal. Although it is evident that the leading HTPs markets – the ones having a market share of more than 10% - have increased the taxes

¹⁸ France created a new excise tax category for heated tobacco products, effective March 2023.

on the new products recently, they all maintained the excise differential policy to the benefit of the new products vs cigarettes.

The excise differentiation to the advantage of HTPs allows for the new products to be sold at a competitive price – in 16 out of the 23 countries the price of a pack of HEETS is lower or equivalent to the weighted average price (WAP) of a pack of cigarettes (2021 data). However, the picture was different in 2019, and the price of HEETS was higher than the weighted average price of a pack of cigarettes in most markets. This shows that in the last couple of years the trend has been for the price positioning of HTPs to be closer to the medium price segment, rather than the premium one.

Interestingly, in half of the cases the price of a pack of HEETS is higher than the weighted average price of a pack of cigarettes in the leading HTPs markets, but it remains within the medium range and is lower than the price of cigarettes in the premium segment. Those are not markets characterised by high affordability of tobacco products, but nevertheless the new products perform well and are gaining market share. Most probably this is because HTPs were perceived as "premium" products, especially in the first years after their introduction.

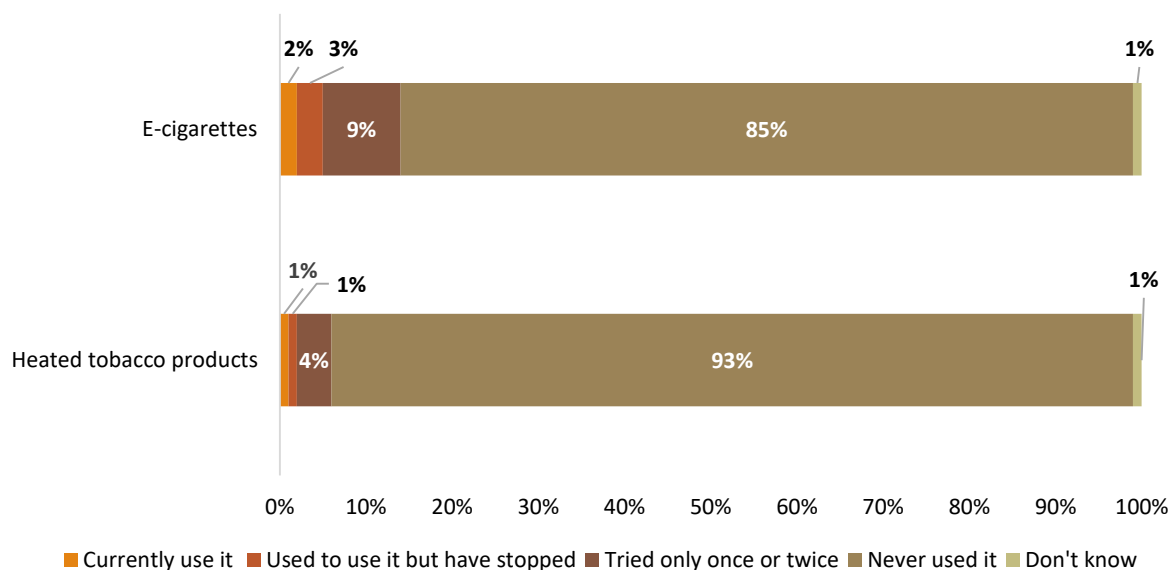
Overall, the data show that affordability and price differential are not key factors for the market uptake of HTPs. Countries with high affordability and high price differentiation in favour of the new products, such as the UK, France, Netherlands, Denmark, and Sweden, are still lagging, whereas countries with low affordability and minimal price differentiation perform well and have a high market share of HTPs. Nonetheless, the competitive price is of great significance for the new products as in almost all markets they are more affordable than the premium cigarette brands. In this case the excise duties play a key role in maintaining the competitive price of the new products.

Introduction of e-cigarettes in Europe

E-cigarettes are widely known on the European market and are available in all EU Member States and the UK. It is much easier for the e-cigarettes to enter the market as they do not contain tobacco and are hence not automatically considered excisable goods like the other tobacco products except when there is an excise framework put in place specifically for e-cigarettes. In the recent years such frameworks have been established in more than half of the EU countries in most cases independent of whether the e-liquids contain nicotine or not, but this happened after the e-cigarettes had already been established and prevalent on the European market.

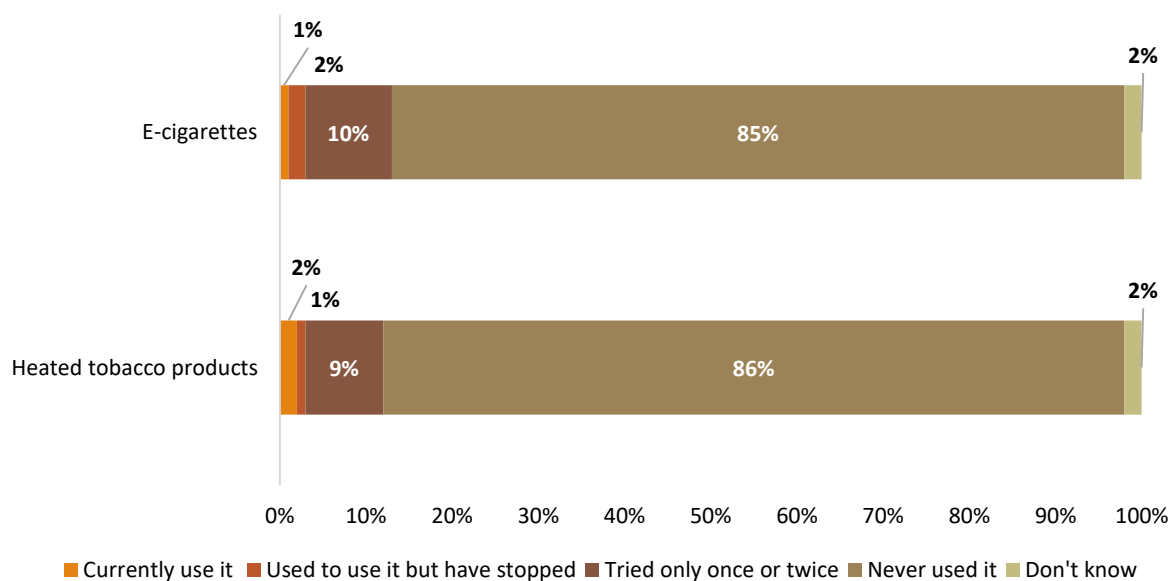
Data from an in-depth Eurobarometer study shows that by 2020 almost 14% of all respondents within the EU and the UK had used or had at least tried e-cigarettes. In comparison according to the same study this percentage for HTPs was about 6%, i.e., e-cigarettes are more well-known and more available than heated tobacco. In most Member States the share of e-cigarette users or the share of those who have tried the products varies from 10% to 20%. The percentage for Bulgaria is 13% with the much higher proportion of respondents reporting that they have tried e-cigarettes at least once but are not regular users.

Figure 2: Share of HTPs and e-cigarettes users in the EU and the UK (% of all respondents, 2021)



Source: Attitudes of Europeans towards tobacco and electronic cigarettes, Eurobarometer (2021)

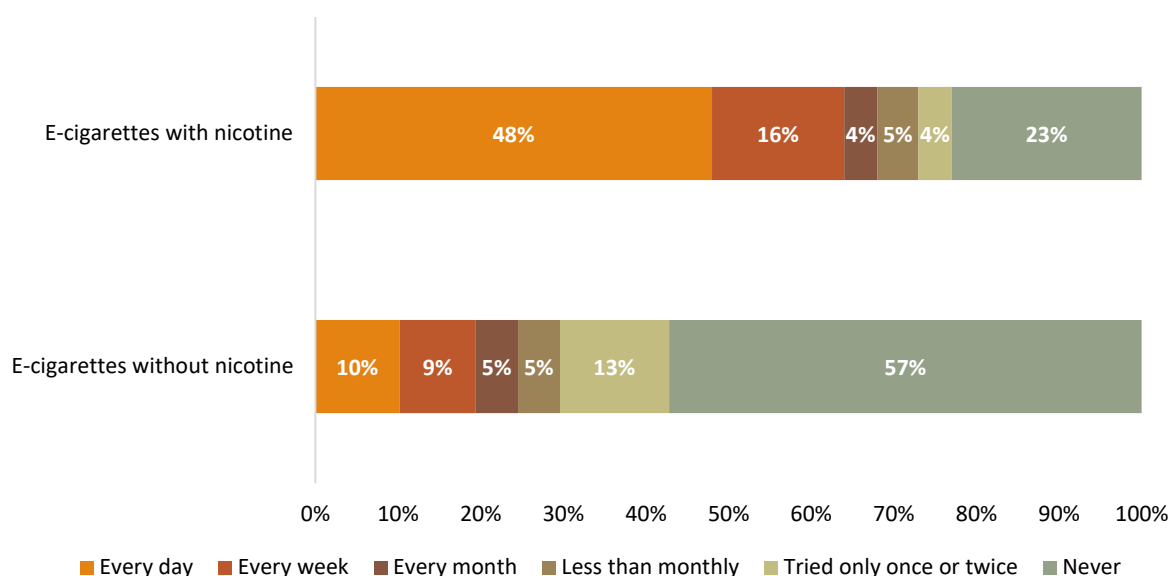
Figure 3: Share of HTPs and e-cigarettes users in Bulgaria (% of all respondents, 2021)



Source: Attitudes of Europeans towards tobacco and electronic cigarettes, Eurobarometer (2021)

The study of the e-cigarette users in the EU and the UK shows that most of them have chosen nicotine-containing e-cigarettes. Almost half of all respondents who have ever used e-cigarettes, use e-cigarettes with nicotine every day. Only 10% of the same group – all who have ever used e-cigarettes – use e-cigarettes without nicotine daily. This means that the development of the e-cigarettes market in Europe is driven by the nicotine-containing products which also serve as another non-combustible alternative to the combustible conventional cigarettes.

Figure 4: Behaviour of the e-cigarette users in Europe and the UK (% of respondents who have reported e-cigarette use, 2021)



Source: Attitudes of Europeans towards tobacco and electronic cigarettes, Eurobarometer (2021)

The analysis of the factors contributing to the prevalence of e-cigarettes is more challenging and not so pressing in our case as the analysis for HTPs because 1) there is no clear market leader publishing detailed data on product use by country and 2) there was no excise framework in place at the initial stages of the introduction of e-cigarettes, therefore there were no serious fiscal barriers for them. The excise framework in the Member States where e-cigarettes are already taxed in terms of rates and tax base for e-cigarettes is similar – specific excise based on the quantity of e-liquid. Despite the data on the prevalent use of nicotine-containing e-cigarettes the trend in most countries is for the excise rates to be the same for all types of e-cigarettes independent of whether they contain nicotine or not, meaning that the nicotine content is not a differentiating factor.

Excise framework for heated tobacco products and e-cigarettes in Europe

Two European directives establish the framework and provisions concerning the harmonized product and fiscal regulation of tobacco products in the EU. The first one is The Tobacco Products Directive (Directive 2014/40/EU) laying down the definitions and rules concerning the presentation and sale of different tobacco and related products. The second one is the Directive on the Structure and Rates of Excise Duties Applied on Manufactured Tobacco (Directive 2011/64/EU) which sets out the requirements for the harmonization of the excise policy, including the specific rules regarding the structure of the excise duties for different types of products and requirements for the minimal excise burden.

The new Tobacco Products Directive (Directive 2014/40/EC) introducing stricter regulations for the different types of tobacco products and a regulatory framework for the new tobacco products and e-cigarettes as of 2016 was adopted in 2014. This Directive contains clear definitions of the new products and establishes rules for their presentation and sale in the EU markets. The new, non-combusted tobacco products and e-cigarettes however have not yet been included in the Directive on the

Structure and Rates of Excise Duties Applied on Manufactured Tobacco (Directive 2011/64/EU) and therefore the national legislators are free to carry out their own (non-harmonized) excise policy with regards to these products. A schematic presentation of the different types of tobacco and nicotine products and the corresponding excise framework at EU level is included in the table below.

Table 4: Excise treatment of select tobacco products at EU level (2022)

| Tobacco and nicotine products and the respective excise framework in the EU | |
|---|---|
| Products included in the common (harmonized) excise framework | Products that are not part of a common excise framework |
| Combusted products (tobacco products for smoking) (Included in Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco – a long history of applying a common excise framework for these products in the EU) | Non-combusted products (Not included in Directive 2011/64/EU and the Member States apply their own national excise framework – their inclusion in Directive 2011/64/EU is under discussion) |
| <p>1.1 Cigarettes (Article 3 of Directive 2011/64/EU)</p> <p>1.2 Cigars and cigarillos (Article 4 of Directive 2011/64/EU)</p> <p>1.3 Tobacco for smoking (Article 5 of Directive 2011/64/EU)</p> | <p>2.1 Heated tobacco products (novel tobacco products containing tobacco)</p> <p>2.2 E-cigarettes (the product does not contain tobacco, but may contain nicotine)</p> <p>2.3 Nicotine products, including pouches (the product does not contain tobacco, but contains nicotine)</p> |

Source: IME based on Directive 2011/64/EU

In this Report we put the focus on the excise treatment of HTPs and e-cigarettes. HTPs are available in 22 EU Member States and in the UK and Switzerland. E-cigarettes are widely accessible within the EU and subject to excise duty in half of the Member States. Despite the absence of a common harmonized framework and the different theoretical arguments for the best excise treatment of the new products and e-cigarettes, it is important to extensively examine the established taxation practices in the individual Member States.

The experience accumulated by the Member States with regards to the excise duties on new tobacco products and e-cigarettes plays a key role in the discussions and the harmonization of the tax treatment of the new products in the EU as related to the revision of Directive 2011/64/EU. The issues that need to be addressed with respect to establishing a common taxation approach for the new products are 1) the definition and the excise category of new non-combusted products and 2) the tax base for the new non-combusted products and the excise rates applied to them, respectively the excise burden. These are the elements that comprise the tax treatment of HTPs and e-cigarettes, and as expected of some other nicotine products such as nicotine pouches, in the EU. Firstly, we will examine in more detail these elements as they relate to HTPs, and then we will outline the general framework as related to e-cigarettes.

Definition and excise category for HTPs

HTPs are new tobacco products that operate on the principle of heating and not burning the tobacco contained in them. The heated tobacco does not generate smoke, but a nicotine-containing vapor as there is no combustion of tobacco like with cigarettes or the other tobacco products for smoking. In the common European framework and in the Bulgarian legislation HTPs fall in the category of

"smokeless tobacco products" (together with other smokeless tobacco products such as chewing tobacco, nasal tobacco, tobacco for oral use such as snus, etc.).

The introduction of HTPs on the European markets requires the establishment of a clear excise framework. As HTPs did not fit into any of the regular excise categories, most EU Member States adopted a separate definition and excise category for the new products. As of the end of 2021, 16 EU Member States had already established a separate excise category for HTPs, i.e., almost all leading markets for the new products. The EU countries that have introduced a separate excise category for the new products are Austria, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Portugal, Romania, Slovakia, and Slovenia. The UK has also created a separate excise category for HTPs. The establishment of a distinct excise category for HTPs shows that the governments treat HTPs as a product that is different from cigarettes and the other tobacco products for smoking. Bulgaria adopted the same practice and included a definition and a separate excise category in the Excise Duties and Tax Warehouses Act. The definition of HTPs in the Bulgarian legislation follows the European practice:

"Heated tobacco product" is a smoke free product whose consumption does not involve burning of the tobacco contained in the product, but which heats it to generate aerosol." (article 12a of EDTWA)

The new products are available on 6 other markets in the EU and are subject to excise duty, but no separate excise category for HTPs has been established at this stage. Those are mostly the markets where the new products have a low share (Germany, Spain, France¹⁹, and Netherlands) or where they are just now being introduced (Estonia and Sweden). In these countries there is no separate category for HTPs, and they are taxed in the same way as tobacco for smoking. This approach may be considered as temporary, because tobacco for smoking is the only possible option for determining the tax base and the taxation level for HTPs in the absence of a separate category.

The reasoning behind the temporary approach is supported by the experience of the successful markets. Lithuania is a good example as the EU country with the highest market share of HTPs. In the first two years after the introduction of HTPs in Lithuania new tobacco products were included in the tobacco for smoking category for tax purposes, and later a separate category was established for HTPs (in force as of March 2019). Also in 2019, after a lengthy public consultation process a separate category for HTPs was introduced in the UK. The main argument was that this was the best approach to the new products and that it ensures a more effective and efficient duty regime on HTPs²⁰.

Tax base and structure of the excise duties on HTPs

The tax base for cigarettes varies in the different markets. Historically, the duties on all tobacco products, including cigarettes, have been levied based on tobacco weight. Over time cigarettes became a more homogeneous and standardized product with clearly defined parameters which led to them being taxed per stick to make it easier for the tax administrations. Currently, the excise duty in the EU is levied based on number of sticks (specific component) and as a percentage of the retail price (ad valorem component). This mixed structure of the excise duty is laid down in Directive 2011/64/EU. Other tobacco products, such as tobacco for smoking, are taxed based on the quantity of tobacco and in some cases as a percentage of the retail price as well. If we disregard the ad valorem component for a moment, we can conclude that the difference in the taxation treatment of the

¹⁹ France recently changed and created a new excise tax category for heated tobacco products, effective March 2023

²⁰ See [Tax treatment of heated tobacco products: response to the consultation](#), HM Treasury (2018)

different products is evident – the excise duty on cigarettes is levied based on number of sticks, whereas the excise duties on other tobacco products are levied based on the quantity of tobacco.

There is a great variety of new tobacco products which can additionally increase in the future with the emergence of more innovations on the market. Although they fall into the same category, they may differ in all other aspects. This means that the common tax base should be based on something that all products have in common. In this case this is the quantity of tobacco in them which in turn means that the tax base should be based on tobacco weight and not some other feature that may be different for the different products and may not be significant in fiscal or health terms. In this respect the most appropriate and fair tax base for HTPs is the weight of tobacco used in the product.

This is the reason why almost all EU Member States which have established an excise framework for HTPs apply the weight of tobacco in the products as a tax base. In at least 20 of all 23 countries (EU+UK) where HTPs are sold the specific excise duty components are calculated based on the weight of tobacco in the product, and not based on number of sticks. The review of the practices applied in the separate countries shows an almost fully harmonized approach without such an approach being laid down in a European directive. Bulgaria also follows this practice and HTPs are taxed only based on the weight of tobacco in the product. The different tax base for the new products and cigarettes is also related to the comparison of the tax burden on the two types of products.

A total of 16 out of the 17 countries (EU+UK) that have introduced a separate excise category for HTPs apply a purely specific excise duty to the new products as of 2022. Of these 17 countries, only Portugal applies a mixed excise structure for HTPs with a specific and an ad valorem component. Of the remaining 6 countries which have not established a separate excise category for HTPs, but where HTPs are available on the market they are subject to excise duty in the same way as tobacco for smoking, half apply a purely specific excise duty and the other half – a mixed structure with a specific and an ad valorem component that is similar to the excise structure for tobacco for smoking in these countries.

Excise framework for HTPs in Europe: summary of the main elements

The review of the different excise frameworks for HTPs in the EU and the UK shows that the approach is similar in most countries. According to 2022, data a total of 16 countries (including the UK) use the weight of tobacco in the product as the tax base and impose a purely specific excise duty on the new products. A total of 13 of these countries have introduced a separate excise category for HTPs and 3 (Estonia, Netherlands and Sweden) apply the existing category of tobacco for smoking on a temporary basis, i.e., there is no difference in the tax treatment of HTPs and tobacco for smoking.

A group of 4 Member States – Portugal, France, Germany, and Spain - adopted a different approach. The first three countries apply a mixed excise structure combining specific excise based on the tobacco quantity in the product and some form of an ad valorem component, whereas Spain uses an ad valorem only excise. All these countries also use minimum excise which is essentially specific – based on the tobacco quantity in the product²¹. Three of these countries apply the same excise category and

²¹This is the reason to assign all these countries in the group applying a mixed structure of the excise duty. Spain applies an ad valorem only excise duty but also uses minimum excise that is specific and does not depend on the price which makes their approach hybrid as well.

respectively excise framework as that for the tobacco for smoking (Spain and France²²) and for pipe tobacco (Germany). In this group only Portugal has introduced a separate excise category for HTPs.

As of 2021, there are two countries remaining that do not fit into the above groups – Italy and Hungary. Both have created a separate excise category for HTPs but employ a different approach. Hungary uses purely specific excise based on number of sticks, while Italy levies excise duty amounting to 30% of the tax burden on cigarettes for the previous year. As of 2021, Hungary and Italy are the only EU Member States that do not use the tobacco weight in the product as a tax base for HTPs. In 2022, Lithuania started to use ‘number of units’ as the tax base of HTPs.

Table 5: Excise framework for HTPs in the EU and the UK (2022)

| Countries | Excise category for HTPs | Tax base for HTPs | Structure of the excise duty on HTPs |
|--|---|---|---|
| Austria, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Greece, Latvia, Poland, Romania, Slovakia, Slovenia, UK | Separate excise category for HTPs | Tobacco weight in the product | Specific excise |
| Italy | Separate excise category for HTPs | % of the excise duty on cigarettes | Specific excise |
| Hungary, Lithuania | Separate excise category for HTPs | Number of sticks (heatsticks) | Specific excise |
| Portugal | Separate excise category for HTPs | Tobacco weight in the product and % of the retail price | Specific and ad valorem excise (+ minimum excise) |
| Estonia, Netherlands, Sweden | Same category as tobacco for smoking | Tobacco weight in the product | Specific excise |
| France, Germany, Spain* | Same category as tobacco for smoking | Tobacco weight in the product and % of the retail price | Specific and ad valorem excise (+ minimum excise) |
| Belgium, Ireland, Luxembourg, Malta, Finland ²³ | HTPs are not available on the market and no excise framework has been put in place (2021) | | |

Source: IME based on different sources, including [Vapor Products Tax](#)

In 2021, the excise burden on HTPs in the EU Member States and the UK was in the range of EUR 70 - 100 per kg tobacco in Poland, Romania, Slovenia, Estonia, and Czech Republic, and more than EUR 200 per kg tobacco in the product in Spain and the UK. Only in France the excise burden is much higher reaching more than EUR 600 per kg tobacco in the product. In some countries the fully specific excise on HTPs is equivalent to the excise levied on tobacco for smoking. In other countries, such as Bulgaria, Croatia, Latvia, Lithuania, and Slovenia however the excise duty on HTPs has been increased and is now higher than the excise on tobacco for smoking.

²² France created a new excise tax category for heated tobacco products, effective March 2023, applying for HTP both per sticks / units tax rate and per weight tax rate as well, depending on and the dimensions of the stick

²³ Finland created a dedicated excise category for HTP with a tax rate per weight of tobacco mixture, but the product is not commercialized in Finland

Excise framework for e-cigarettes

E-cigarettes, though they also have an electronic heating element and are essentially non-combustible products, differ from HTPs in that they do not contain tobacco. The absence of tobacco in the e-cigarettes is the reason why the institutions do not treat them as excisable goods when there is no special excise framework for them in place²⁴. Over the years e-cigarettes gradually came onto all the EU markets without being taxed like all other tobacco products, including the novel HTPs. This has been changing in recent years and a growing number of countries are starting to levy excise duty on e-cigarettes as well.

In 2021, half of the EU Member States applied an excise framework for e-cigarettes. The specificity of these products makes it necessary to adopt a separate definition and excise category. Unlike HTPs, with e-cigarettes it is impossible to temporarily use another excise category such as tobacco for smoking, because they not only do not involve combustion, but also do not fit into the tobacco products category. E-cigarettes fall into the group of related tobacco products. As e-cigarettes may contain nicotine, they should be treated as part of the overall nicotine market.

The specificities of e-cigarettes, including the variety of products, predetermine to a great extent the choice of definition, excise category and tax base. All Member States that have introduced an excise framework for e-cigarettes adopted a separate definition and excise category for e-cigarettes and all levy a purely specific excise duty, i.e., without an ad valorem component, based on the e-liquid quantity (i.e., per ml of the liquid volume). The big question and therefore the big difference in the approach is whether tax is imposed only on e-cigarettes containing nicotine or on all e-cigarettes independent of whether they contain nicotine or not.

The 2021 data show that a total of 13 EU Member States have adopted an excise framework for e-cigarettes. These are Cyprus, Greece, Hungary, Italy, Latvia, Lithuania, Poland, Portugal, Romania, Slovenia, Estonia, Finland, and Sweden. All these countries, except for Estonia and Sweden, have also introduced a separate excise framework for HTPs. Moreover, this group includes almost all the leading and developing HTPs markets in the EU which indicates that these countries outpace the harmonization process for the new products and set the trend for both HTPs taxation and e-cigarettes taxation.

All the above countries apply a purely specific excise on e-cigarettes based on quantity of e-liquid in the product. A total of 8 out of the 13 Member States apply the same excise duty on the e-cigarettes with nicotine and without nicotine. 3 of the other 5 Member States do not tax the e-cigarettes without nicotine and 2 apply lower excise rates for the non-nicotine products. Generally, it is notable that the countries which start levying excise duty on e-cigarettes often tax all products independent of whether they contain nicotine or not.

The specific excise duty based on millilitre of e-liquid in the e-cigarettes in these countries varies from EUR 0.08 per millilitre in Hungary and Italy, and EUR 0.10-0.12 per millilitre in Greece, Romania, Cyprus, Latvia, Lithuania, and Poland to EUR 0.30-0.32 per millilitre in Portugal and Finland. If we make a comparison with the excise duty levied on the other new non-combustible products – HTPs – using

²⁴This interpretation is disputable as the nicotine-containing e-liquid is derived from tobacco. In other words, a case can be made that the logic applied to tobacco products can be applied to e-cigarettes. Nevertheless, the practice in the EU Member States is that in the absence of a special excise framework for e-cigarettes they can be commercialized without being taxed.

the ratio of 1 millilitre of e-liquid = 10 sticks of HTPs, then the excise burden on e-cigarettes is significantly lower than that on HTPs.

Table 6: Excise framework for e-cigarettes in the EU (2021)

| Country | Excise on nicotine-containing e-liquids | Excise on non-nicotine e-liquids |
|-----------|--|-------------------------------------|
| Croatia | zero | zero |
| Cyprus | EUR 0.12/ml | EUR 0.12/ml |
| Estonia | Temporary zero until 1 January 2023 | Temporary zero until 1 January 2023 |
| | EUR 0.2/ml after 1 January 2023 | EUR 0.2/ml after 1 January 2023 |
| Finland | EUR 0.30/ml | EUR 0.30/ml |
| Greece | EUR 0.10/ml | EUR 0.10/ml |
| Hungary | HUF 30 (EUR 0.08)/ml | HUF 30 (EUR 0.08)/ml |
| Italy | EUR 0.084/ml | EUR 0.042/ml |
| Latvia | EUR 0.12/ml | EUR 0.12/ml |
| Lithuania | EUR 0.12/ml | EUR 0.12/ml |
| Poland | PLN 0.55 (EUR 0.)/ml | PLN 0.55 (EUR 0.11)/ml |
| Portugal | EUR 0.32/ml | 0 |
| Romania | RON 0.55 (EUR 0.11)/ml | 0 |
| Slovenia | EUR 0.18/ml | EUR 0.08/ml |
| Sweden | SEK 2 (EUR 0.18)/ml: for e-liquids with nicotine concentrations above 15 mg/ml | 0 |
| | SEK 4 (EUR 0.36)/ml: for e-liquids with nicotine concentrations above 15 mg/ml | |

Source: IME based on different sources, including [Vapor Products Tax](#)

*Note: Germany and Denmark also introduced excise duty on e-cigarettes with entered into force on 1 July 2022.

At the end of 2022, Bulgaria also introduced excise duty on e-cigarettes, more specifically on the nicotine-containing e-liquids. The adopted excise rate of BGN 0.18 or EUR 0.09 per millilitre which took force on 1 January 2023 is close to the minimal rates in Europe and slightly higher than the rates in Hungary and Italy. In 2023, however, changes in the taxation of e-cigarettes were adopted, with the excise rate rising to BGN 0.30 per milliliter from August 1, 2023. The new excise calendar foresees that in 2026 the excise duty will reach BGN 0.45 (or EUR 0.23) per milliliter, which would already be significantly higher than neighboring countries and other CEE countries.

The changes in the excise calendar adopted in 2023 affect not only the excise rate, but also the scope of the excise framework. The new framework envisages changes in the taxation of e-cigarettes, with the aim of 1) taxing all e-liquids - regardless of whether they contain nicotine or not, and 2) introducing an excise rate for nicotine-containing tobacco substitutes – this includes the so-called nicotine pouches. The excise calendar sets excise duty on all e-cigarettes at BGN 0.30 per milliliter from 1 July 2023, rising to BGN 0.45 per milliliter in 2026. Excise duty on nicotine-containing tobacco substitutes will rise gradually from BGN 90 per kilogram in 2023 to BGN 115 per kilogram in 2026.

Impact of the excise framework on the consumption of new products and the substitution effect

The substitution effect on product consumption brought about by the taxation policy refers to situations in which the demand for a product is stimulated as a result of the higher taxation of other similar products. In the discussion about tobacco and related products, the wider substitution effect may relate to all the products on the same nicotine market. The excise duty on e-cigarettes, if such is levied, is significantly lower than the excise duty on the products for smoking and particularly cigarettes as e-cigarettes are a non-combustible product. The current excise framework for HTPs, also non-combusted products, is also more favourable compared to the framework for cigarettes as the common practice in Europe shows. In other words, the excise framework for the new non-combusted products in almost all European countries supports the substitution of conventional tobacco products for smoking with the new non-combusted products. This observation should however take into account both the different tax base, respectively comparing the excise duty based on the quantity of common consumable element (i.e., weight of tobacco / volume of e-liquid in the product, and the higher barriers to the consumption of new products, including the need to get an additional device and the different usage modes of the new products.

Theoretical and practical considerations

From a theoretical point of view, the tax induced substitution of products is possible or effective when the new substitute products are clearly differentiated between each other and from the existing products on the market. This makes it easier to encourage the substitution of strictly regulated goods. And the excisable goods are exactly such goods for which clear definitions are provided to avoid all doubt regarding the individual characteristics of the different products and strict control mechanisms are put in place.

Tobacco is one of the most regulated goods worldwide which makes tobacco products a suitable target of policies aiming to achieve tax-induced substitution of consumption. There are clear common definitions for the traditional, combusted tobacco products which are applied across the EU. Cross-border sales are regulated and controlled, and in 2020 a comprehensive product tracking and tracing system was implemented. In most EU markets, there are now specific definitions for HTPs, and they are mostly subject to separate excise regimes, which means that they are already well regulated. In this respect the goal of the tax-induced substitution is clear – to persuade the consumers to switch from one regulated and strictly controlled product (cigarettes) to another regulated and strictly controlled product (HTPs).

The case of HTPs slightly diverts from the standard definition of tax—induced substitution of consumption which usually refers to imposing higher taxes on products that are less desirable for the purposes of the respective policy. In the case of HTPs, the other product is already heavily taxed, and a new product is introduced with a lower tax burden. This is similar to other types of incentives for instance for electric vehicles compared to vehicles with internal combustion engines. There are different innovative policies that create a more favourable tax and regulatory environment for electric vehicles relative to the traditional vehicles. The free parking in the city centres for electric vehicles and the differentiated taxation are such policies aimed at providing regulatory/tax incentives for the less polluting vehicles in the densely populated regions.

The substitution effect is crucial when we talk about tax-induced consumption substitution. The objective of this policy is to shift the consumer preferences towards the more desirable product health-wise. This means that the reduced harm from the product that is subject to more favourable treatment should be broadly accepted. In the case of HTPs, these are the health effects from switching to a potentially less harmful product. The effects for the budget revenues from the excise policy concerning the new products are important, but for this policy to be effective in the long-term the health effects should be broadly accepted. The clear position of the government or supranational health authorities is vital for the sustainability of the long-term excise treatment.

Tax-induced substitution affects not only consumer behaviour, but also the strategies of the major manufacturers in the market. The effects on the supply should not be overlooked as they may be key for achieving the health objectives. As data about the price differences show HTPs are not always cheaper than the cigarettes in the middle segment and in some of the leading markets their price is even higher than the weighted average price of cigarettes. The incentive for the consumers to switch to the new product is based on the understanding that this product is better, specifically in terms of its health benefits and not so much on its price as in most cases the consumers will not save money by using HTPs especially when the cost of purchasing the new device is added. The incentive on the supply side however is strong because the excise tax differential allows the companies to continuously invest to introduce the new product and be competitive. The consumers can still appreciate the benefits of the new product even without preferential excise treatment (although it will most probably remain unaffordable), but the companies may not have an incentive to develop the market for the product or the ability to offer the product at a reasonable/competitive price.

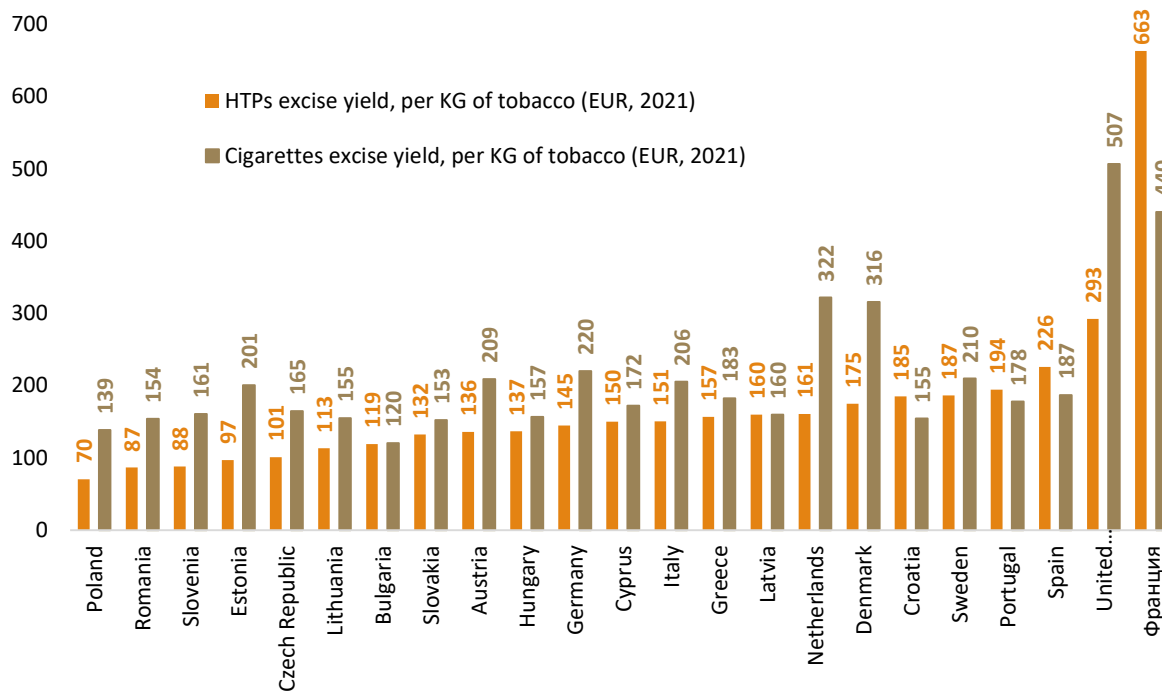
Excise differentiation of the new products

As HTPs pose potentially lower health risk compared to cigarettes and the other combusted tobacco products, it can be expected that the excise framework for the new products should be more favourable than that for cigarettes. This is the case in almost all EU Member States that have introduced an excise framework for HTPs – the tax burden on HTPs is lower than the excise burden on cigarettes calculated based on the tobacco quantity in the product. In 2021, the average excise burden on HTPs in EU is about EUR ~170 per kilogram of tobacco while the excise burden on cigarettes is about EUR ~210 per kilogram tobacco.

The so-called excise differential shows that the excise burden on HTPs varies from about 50% to 90% of the excise burden on cigarettes calculated based on kilogram of tobacco in the products. In most Member States the excise differential is in favour of the HTPs and there is only a small number of examples of higher excise burden (based on the tobacco weight in the product) on HTPs compared to cigarettes. In almost all leading and developing HTPs markets the excise differential is more favourable for the new products, especially in the initial years of their introduction on the market.

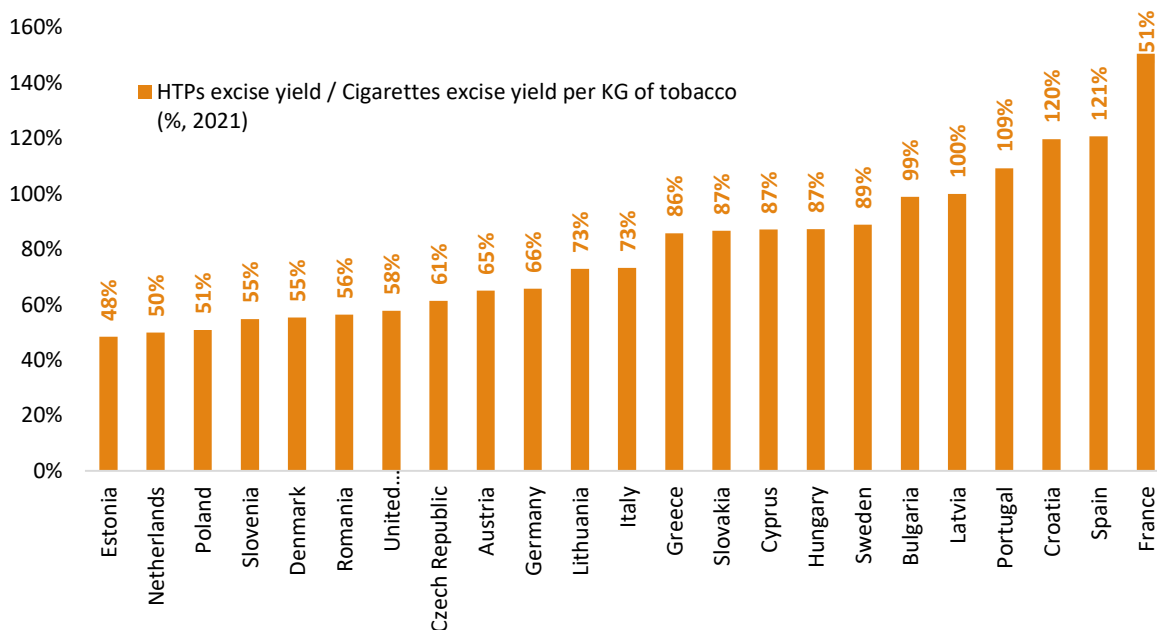
The picture in Bulgaria was similar when the excise framework for HTPs was first introduced in 2017, but the excise duty on HTPs was increased soon thereafter and now the excise burden on HTPs and cigarettes based on tobacco quantity in the product is practically equivalent. According to the proposed excise calendar until 2026 which provides for a sharp increase of the excise duty on HTPs the excise burden on the new products will essentially be higher than that on cigarettes calculated based on tobacco quantity in the product. In contrast, the tax regime for tobacco for smoking which was subject to excise duties equivalent to those for HTPs is currently more favourable compared to the regime for the other products.

Figure 5: Excise burden on HTPs and cigarettes based on kg of tobacco in the product (EUR, 2021)



Source: IME based on Excise Duty Tables

Figure 6: Excise burden – HTPs/cigarettes based on kg of tobacco in the product (% , 2021)



Source: IME based on Excise Duty Tables

If we compare the excise burden but not based on the weight of tobacco in the product, but based on number of sticks or packs, the excise differential is even more favourable for HTPs because the sticks of the new products contain less tobacco than cigarettes. Calculated based on sticks the excise burden on HTPs was in the range from 20% to about 60% of the excise burden on cigarettes as of 2021. When the excise burden is calculated using this calculation method it is significantly lower than the excise burden on a pack of cigarettes in all Member States. In virtually, as of 2021, all the Member States except for France the excise burden (per pack) on HTPs was less than 50% of the excise burden per pack of the best-selling cigarette brand. The excise differential for the end product (pack of HTPs and pack of cigarettes) is an incentive for the companies to invest and develop new products.

Effects of legal uncertainty on consumers and the market for new products

The market prevalence of the new products is almost entirely dependent on the legal framework in the different countries. Currently, most Member States have introduced an excise framework for HTPs thus making their commercialization possible. As these products are new, the legal/excise framework is also new which creates a certain level of legal uncertainty. This is evident from several examples of legislative initiatives and policy proposals in Europe aimed at either overhauling the excise framework or significantly increasing the excise burden on the new products.

As the country with the lowest gross domestic product (GDP) per capita in the EU and one of the highest smoking rates in Europe, Bulgaria adopted an excise framework for HTPs in 2017. The new framework was essentially aligned with the best practices in the other Member States – separate excise category, purely specific excise based on the tobacco quantity in the product and distinct differentiation from conventional cigarettes. But less than a year after the introduction of the excise framework the government proposed a revision of the excise regime for the new products.

The initial proposal was not only to increase the excise duty on HTPs, but to apply the same regime for HTPs and cigarettes – in other words to change the tax base for the new products and increase the tax burden fivefold. The proposal was supported by the Ministry of Finance and for a few weeks it created a shockwave effect for the companies and the consumers who have already switched from cigarettes to the new products in Bulgaria. Although the initial proposal was not approved in Parliament, it shows how vulnerable the market is to abrupt changes in the policies.

Effects from the introduction of new products and the implemented excise framework on the tax revenues

The market for HTPs in the EU is growing and that means that the impact on the tax revenues should be carefully examined. This is also valid about e-cigarettes given that their market share is also growing, and the excise framework is favourable, i.e., the excise burden is lower than that on combustible tobacco products. The excise burden (based on tobacco weight in the product) on HTPs is usually between 50% and 90% of the burden on cigarettes. This means that the substitution of conventional tobacco products (mainly cigarettes) with new products (HTPs and e-cigarettes) may cause revenue divergence – loss of potential revenues that would have been collected in the absence of a substitution effect, i.e., there is no consumption of new products instead of conventional cigarettes or the new products are simply taxed in the same way as cigarettes.

Here we will assess the revenue divergence for the EU as a whole resulting from HTPs consumption and will also explore the connection between the tax revenues and the health objectives. The impact of the excise duty on tobacco products and the evolution of the tobacco excise revenues will also be analysed as they put the argument about revenue divergence due to the new products in perspective. The focus will be put mainly on HTPs as innovative products containing tobacco which can replace cigarettes, but e-cigarettes should not be overlooked along with the other non-combustible tobacco substitutes. The latter are already available on the markets of all Member States and are either not treated as excisable goods or are subject to preferential excise treatment compared to both cigarettes and HTPs.

Revenues from the traditional combusted tobacco products

More than 90% of the excise revenues from tobacco products in the EU come from cigarettes. In most Member States this share is even higher than 95% and only in a small number of countries the excise revenues from other tobacco products are about 10% or more of the total revenues from tobacco products. Those are mainly countries with high share of tobacco for smoking such as Belgium, Germany, France, and Netherlands. While in the past 12 years cigarette consumption in the EU (UK excluded) has declined from more than 660 billion sticks in 2008 to about 407 billion sticks in 2022 – a drop by more than 1/3 in 14 years – the excise revenues have in fact increased in most markets and especially in the new Member States as a result of the increases of the excise duties there. The total excise revenues from cigarettes in the EU exceeded EUR 68 billion in 2021 (compared to EUR 65 billion in 2018) which is about 1% of the total national revenues in the EU. In some countries however the percentage is much higher, Bulgaria being at the top of the list with close to BGN 2.9 or 4.9% of the of the total consolidated national revenues come from cigarette excise.

When reviewing the effects from the increased consumption of HTPs on the budget revenues we need to consider the latest developments on the cigarette market. Although cigarette consumption has fallen in the recent years, the data show that most EU countries report higher revenues from cigarette excise in both 2020 and 2021. No serious decline in the revenues from cigarette excise was observed in most leading HTPs markets. The stable revenues from cigarette excise are supported by the moderate increase of the excise duty in some countries and the subsequent slight increase of the prices, but also by the improved affordability in the recent years on some markets. The data indicate that the 20 EU Member States where HTPs are available on the market (launched before 2020) report an increase of EUR 2.5 billion (4.2% growth) of the revenues from cigarette excise in the period 2018-2020.

The situation is similar in Bulgaria. Despite the growth of the new tobacco products in the recent years, cigarette consumption in the country went up from about 14 billion sticks in 2018 to about 16 billion sticks in 2022. The revenues from excise on tobacco products, including cigarettes, also increased, and reached BGN 3 billion in 2022 with revenue growth of BGN 166 million in 2022 only. There was no significant increase of the excise burden in this period meaning that the increase in revenues is related to the higher consumption of tobacco products. The sustained growth in the revenues from cigarette excise together with the adopted excise calendar for the increases in the tobacco taxation allow for a more flexible policy on the new products.

Tax revenue divergence from the commercialisation and taxation of new products

Estimating and fully understanding the revenue divergence from the introduction and taxation of new products is important, because the government budgets depend on the tobacco excise revenues and any significant decline in the revenues due to the growing market share of HTPs may put pressure for changes to the policy on the new products. It is important to note that we are essentially calculating a hypothetical divergence assuming that either cigarette consumption will be fully replaced by HTPs consumption or that the excise duty on HTPs will be the same as that for cigarettes and hence the effect of the consumers' choice will be budget neutral. Although the calculation is hypothetical, it is still methodologically sound and can be used to gain better understanding of the effect on public spending from the introduction of HTPs.

We use the total HTPs market in the EU for the calculation. The estimates of PMI show that the total HTPs market in the EU amounted to 28 billion units (1.4 billion packs) in 2021. Assuming an average excise burden on a pack of HTPs of about EUR 1 the total revenues from HTPs excise in the EU should be about EUR 1.4 billion in 2021. We assume that the average revenue from the excise (per kg tobacco) on HTPs is about 70% of that on cigarettes. The calculation shows that the potential revenue divergence resulting from the lower excise duties on HTPs in the EU is less than 1% of the total revenues from excise on tobacco products in 2021. If we assume hypothetically that the excise burdens per pack of HTPs and pack of cigarettes (and not per tobacco quantity) become even, then the potential total revenue divergence may come to 4% of the total revenues from tobacco products excise in the EU for 2021.

Revenue divergence: HTPs vs tobacco for smoking

Although the market shares of HTPs in the EU grew steadily from 1.2% in 2018 to 2.5% in 2019, and 4.2% in 2020 and 5.7% in 2021, the market share of fine cut tobacco remains significantly higher – stable around 20% in the past years. The consumption of tobacco for smoking which is subject to a more favourable excise regime than cigarettes without any health arguments for such treatment is still outpacing the consumption of HTPs. The EU-wide data should be interpreted with caution however because the share of tobacco for smoking is higher (more than 20-30%) in some countries – Belgium, Hungary, Netherlands, and Germany – and very low (less than 10%) in others.

In any case the excise framework for tobacco for smoking is more favourable than that for cigarettes in all EU Member States, and in some markets the excise rates for the new products and tobacco for smoking are practically the same. Even given the growth of the new products in 2019 and 2020 the excise revenues from tobacco for smoking are almost 20 times higher than the revenues from the excise on HTPs. This means that the revenue divergence arguments remain more compelling with respect to tobacco for smoking, as the hypothetical budget losses in this case are much bigger. The new products have a relatively comparable market share only in countries where the market share of tobacco for smoking has traditionally been low.

The market share of tobacco for smoking in Bulgaria is also higher than the share of HTPs. In 2022, the taxed quantities of tobacco for smoking amounted to about 518 tons, while the taxed quantities of tobacco used in HTPs were a little more than 300 tons. At the same time, the excise burden on HTPs in Bulgaria is higher than that on tobacco for smoking – BGN 282 per kilogram tobacco in HTPs vs BGN 167 per kilogram tobacco for smoking. This is why the revenues from the two types of products are similar – BGN 79 million in excise revenues from tobacco for smoking vs BGN 70 million in excise revenue from HTPs. The adopted excise calendar provides for sharp increases of the excise duty on HTPs in the next years as compared to the excise on tobacco for smoking and in 2026 the difference is expected to double, i.e., the excise differential will be strongly in favour of the tobacco for smoking vs the new products.

As the calculation of the revenues' divergence is hypothetical, whether it will be accepted depends on the total tobacco revenues. As already mentioned, the revenues from the excise duties on tobacco products, mainly cigarettes, go up in mainland Europe and thus the revenues' divergence is not only relatively low, but somewhat hidden under the surface. Although there are different trends on the markets – some see a slight decline in the cigarette excise revenues – in the overall picture the increased cigarette excise revenues lift the pressure on the budgets from the increasing market share of the new products. Considering the potential for collecting revenues from excise duties on different categories of tobacco products, the future increases of the excise rates for cigarettes and tobacco for smoking may generate actual revenues to offset the hypothetical loss of revenues.

The new products and the policy objectives

The objective of the excise duties on tobacco products is to reduce tobacco consumption (and cigarette smoking especially) because it produces the most negative health effects – this is the obvious health objective of the excise duty. In the past decades, however, as the governments became more dependent on the tobacco excise revenues, the budget objective, i.e., getting revenues from the excise duty on tobacco products, started to play a more important role on some markets. The excise policy on tobacco products should be carefully shaped because these two objectives are not only contradictory at times, but in some cases, especially when the excise burden is sharply increased, both objectives may be compromised and not achieved – for instance if the illegal trade increases the total consumption may not go down, but the legal market and the budget revenues will decrease. This has happened several times in the EU with the most flagrant examples being the tax disruptions in the new Member States, including Bulgaria, Lithuania, etc., in the period 2008-2010.

Many things should be taken into consideration when establishing a long-term policy on the new product. Firstly, it is crucial to confirm that the substitution of combusted tobacco products with HTPs is the preferred health option, which means that this substitution produces better results in terms of achieving the health objective and reducing the healthcare costs in the long run. It is evident from the debates in the national parliaments in connection with the establishment of an excise framework for HTPs that the health authorities in the Member States do not always take a clear stance concerning the new products. Even though almost all Member States have introduced an excise framework that is favourable for the new products, the health rationale for the different rates is not clearly supported by the national health authorities and is hence more vulnerable.

Secondly, after the health debate is settled, it is important to understand that the future development of the new products will lead to further declines in the cigarette consumption which will at some point result in lower revenues from tobacco excise. This however may take time, because there are many opportunities for managing the excise duties on cigarettes and the other combusted tobacco products and hence collecting more revenues from the traditional tobacco products. Increasing the excise duty on cigarettes and the other traditional products for smoking may offset the loss of revenues due to the more favourable excise framework for the new products. But the policy should not assume that the revenues from tobacco will constantly grow. The dependence on tobacco excise revenues should be reduced in the long-term. This is especially valid for countries like Bulgaria, which are disproportionately dependent on tobacco excise as compared to the other EU countries.

Conclusion and policy recommendation concerning the new non-combustible products

The market for HTPs in Europe grows at different rates with the new products being very successful in some markets and still being established on others. Different factors drive these processes, including the characteristics of the different markets and the smokers' habits, but also the excise framework applied to the new products. The new products perform well in markets with high share of smokers overall and high share of smokers who have never attempted to quit where HTPs reach a high market share – more than 10%, and in some cases more than 20% of the total tobacco market. This supports the argument that HTPs may be considered as an alternative to the combusted tobacco products.

The excise framework for the HTPs plays an important role for their market uptake. According to the review most countries follow a similar practice – 18 EU countries apply fully specific dedicated excise framework without an ad valorem component while 4 use a mixed excise structure. The common practice in Europe is for the excise burden on HTPs to be lower than the excise burden on cigarettes – adjusted for quantity of tobacco in the products with the excise burden on the new products ranging from 50% to 90% of the excise burden on cigarettes.

The revenue divergence resulting from the growth and taxation of HTPs in the EU based on the differences in the excise burden and calculated per kilogram is about 1% of the total revenues from excise on tobacco products for 2021. As the calculation of the revenues' divergence is hypothetical, whether it will be accepted depends on the total tobacco revenues and more specifically cigarette excise revenues. The revenues from excise duties on tobacco products, mainly cigarettes, went up in mainland Europe and this lifted the pressure off the national budgets. Nevertheless, as some countries increase the excise duties on HTPs in the first or second year after their introduction, there seems to be a high level of regulatory uncertainty. The favourable excise framework for HTPs will probably be put under additional pressure because the market share of the new products is growing, and the governments are trying to balance between achieving the health objectives and achieving stable budget revenues.

In the recent years Europe introduced excise frameworks for both HTPs and e-cigarettes. Half of the EU Member States already levy excise duties on e-liquids with the main differentiation being whether the product contains nicotine – some countries tax only the nicotine-containing e-cigarettes. The common approach is to have a separate excise category for the e-cigarettes and to apply purely specific excise based on the quantity of e-liquid (per ml) in the product. This approach was adopted in Bulgaria as well in 2023.

Bulgaria follows the trends in the taxation of new non-combusted products in Europe. The framework for the HTPs is in line with some of the good examples in the EU – separate excise category and purely specific excise duty, based on tobacco weight, on the new products. The excise burden on HTPs in Bulgaria however is relatively high and there is essentially no excise differentiation with cigarettes when the excise burden is calculated based on the tobacco quantity in the product. With the excise calendar until 2026 and the steeper increase of the excise on HTPs, Bulgaria will become one of the few EU countries where the excise on HTPs will be higher than that on cigarettes calculated based on tobacco weight in both products and higher than tobacco for smoking.

Several policy recommendations can be made based on the analysis. In terms of the excise framework, the special excise category for the new products is important because it allows for their differentiation from the combusted tobacco products. The separate framework also facilitates the more favourable tax treatment of HTPs as the excise duty (based on the tobacco weight in the product) on HTPs is usually about 50-90% of the excise on cigarettes. Such an excise gap is crucial for the commercialization of HTPs and for encouraging the manufacturers to redirect their investments away from cigarettes and towards new products.

The most advisable option is to apply a purely specific excise duty based on the tobacco weight in the product as in this way the excise revenues will be independent of the price of the new products. The more favourable regulatory environment for HTPs compared to cigarettes – especially with regards to advertising and the regulation of the points of sale – is also a preferred option because the highly restrictive regulations limit the access of the current smokers to the new products and hinder their awareness of these products.

Despite the high level of regulatory uncertainty with regards to these products, the adoption of an excise calendar (usually a plan for a 3-to-5-year period) may be very beneficial for the entire tobacco market. Such calendars have been used in different Member States mainly for the gradual increase of the cigarette excise in the past 10 years. Currently, such a calendar could not only include the plans concerning the excise duties in the next 3-5 years, but also provide legal certainty for the favourable excise framework for HTPs in the mid-term. Since the governments are dependent on the tobacco excise revenues, the excise calendar can also be used for the purposes of the good planning and management of excise revenues.

Specifically, for Bulgaria it is important to maintain the current taxation framework for HTPs as it is aligned with the best European practice. The steeper increase of the excise on HTPs until 2026 however seems to depart from this model. Although many of the leading markets for HTPs increase the excise duty on the new products and narrow the excise gap with cigarettes, almost all maintain the favourable framework for HTPs. This framework provides strong incentives for the companies to invest in the development of new products. At the same time, given the forthcoming increase of the cigarette excise and the broader taxation of all products available on the total nicotine market, including nicotine-containing substitutes, the revenues from the taxation of the various tobacco and nicotine products in Bulgaria can be expected to steadily grow.

Annex I: Tobacco market in selected countries

| Country | Category | Estimate of the market in 2021 (in equivalent to billion sticks) | Share (%) of the total tobacco market (2021) |
|----------------|------------|---|---|
| France | Cigarettes | 34,1 | 70.2% |
| | HTPs* | 0,2 | 0.4% |
| | OTPs** | 14,3 | 29.4% |
| | Total | 48,6 | 100.0% |
| Germany | Cigarettes | 71,6 | 62.1% |
| | HTPs | 2,4 | 2.1% |
| | OTPs | 41,3 | 35.8% |
| | Total | 115,3 | 100.0% |
| Italy | Cigarettes | 61,1 | 76.7% |
| | HTPs | 9,3 | 11.7% |
| | OTPs | 9,3 | 11.7% |
| | Total | 79,7 | 100.0% |
| Poland | Cigarettes | 45,5 | 79.7% |
| | HTPs | 3,8 | 6.7% |
| | OTPs | 7,8 | 13.7% |
| | Total | 57,1 | 100.0% |
| Spain | Cigarettes | 42,1 | 74.0% |
| | HTPs | 0,5 | 0.9% |
| | OTPs | 14,3 | 25.1% |
| | Total | 56,9 | 100.0% |
| Croatia | Cigarettes | 5,7 | 87.7% |
| | HTPs | 0,4 | 6.2% |
| | OTPs | 0,4 | 6.2% |
| | Total | 6,5 | 100.0% |
| Czech Republic | Cigarettes | 15,2 | 80.0% |
| | HTPs | 2,1 | 11.1% |
| | OTPs | 1,7 | 8.9% |
| | Total | 19,0 | 100.0% |
| Greece | Cigarettes | 11,1 | 63.4% |
| | HTPs | 2,0 | 11.4% |
| | OTPs | 4,4 | 25.1% |
| | Total | 17,5 | 100.0% |
| Hungary | Cigarettes | 6,9 | 43.7% |
| | HTPs | 1,6 | 10.1% |
| | OTPs | 7,3 | 46.2% |
| | Total | 15,8 | 100.0% |

| | | | |
|--|------------|------|--------|
| Latvia | Cigarettes | 1,7 | 85.0% |
| | HTPs | 0,2 | 10.0% |
| | OTPs | 0,1 | 5.0% |
| | Total | 2,0 | 100.0% |
| Lithuania | Cigarettes | 2,4 | 72.7% |
| | HTPs | 0,7 | 21.2% |
| | OTPs | 0,2 | 6.1% |
| | Total | 3,3 | 100.0% |
| Portugal | Cigarettes | 8,8 | 80.0% |
| | HTPs | 1,2 | 10.9% |
| | OTPs | 1,0 | 9.1% |
| | Total | 11,0 | 100.0% |
| Romania | Cigarettes | 25,7 | 94.5% |
| | HTPs | 1,3 | 4.8% |
| | OTPs | 0,2 | 0.7% |
| | Total | 27,2 | 100.0% |
| Slovakia | Cigarettes | 6,4 | 87.7% |
| | HTPs | 0,9 | 12.3% |
| | OTPs | 0,0 | 0.0% |
| | Total | 7,3 | 100.0% |
| Slovenia | Cigarettes | 3,2 | 86.5% |
| | HTPs | 0,3 | 8.1% |
| | OTPs | 0,2 | 5.4% |
| | Total | 3,7 | 100.0% |
| Switzerland | Cigarettes | 8,9 | 79.5% |
| | HTPs | 0,6 | 5.4% |
| | OTPs | 1,7 | 15.2% |
| | Total | 11,2 | 100.0% |
| UK | Cigarettes | 23,7 | 61.4% |
| | HTPs | 0,5 | 1.3% |
| | OTPs | 14,4 | 37.3% |
| | Total | 38,6 | 100.0% |
| Bulgaria (estimate of IME for 2022) | Cigarettes | 15,9 | 87,4% |
| | HTPs | 1,0 | 5,5% |
| | OTPs | 1,3 | 7,1% |
| | Total | 18,2 | 100% |

Source: Philip Morris International Investor Information (2022)

*HTPs – heated tobacco products

**OTP – other tobacco products, including roll-your-own tobacco

***As there is not data about Bulgaria in the PMI Report, the data about Bulgaria are estimates of IME for 2022