

**DIALECTICS
OF THE REFORM
OF THE EXCISE
TAXATION OF TOBACCO
PRODUCTS IN UKRAINE:
EUROINTEGRATION ASPECT**

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The paper reveals the scientific approaches to the transformation of the excise taxation of tobacco products in order to achieve the objectives of fiscal consolidation and the fulfillment of the requirements of the Association Agreement with the EU. The tendencies of development of mechanisms of taxation of excise taxes on tobacco products in the EU countries in the context of new challenges and threats are analysed, special attention was paid to the practice of raising the level of taxation of these excisable goods in certain EU countries. Problems in the realisation of the fiscal and regulatory potential of excise taxation of tobacco products in Ukraine are revealed. The directions of reformation of excise taxation of tobacco products in Ukraine are grounded, taking into account the requirements of EU directives and European experience.

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Introduction

The problem of improving the approaches to tax regulation of individual commodity markets remains one of the main issues in the implementation of economic transformations in Ukraine. These markets include tobacco. It is strategically important in today's socio-economic conditions, especially considering the fiscal role of excise taxation. It is also important to take into account the fact that the quality of the implementation of specific excise duty of a regulatory function depends on the country's chosen tax mechanisms and the effectiveness of state control over the production and circulation of goods of the excisable group.

Today, Ukraine faces serious challenges in the field of excise taxation of tobacco products, which is due both to the processes of adapting domestic legislation to the requirements of the EU common law (according to the Association Agreement) and to the increase of excise duty on tobacco products to overcome the imbalance of public finances, and to the need to improve the mechanism for administering the excise tax on these goods, which is the consequence of the application by individual market participants of a number of schemes for the reduction of tax payments (which in their essence is tax evasion and avoidance).

Given the above, the scientific substantiation of the directions of the transformation of the excise taxation of tobacco products in Ukraine in the context of the implementation of the Association Agreement with the EU, while taking into account the domestic features of the tobacco market and the need to improve the mechanisms for administering the excise tax on these goods, is particularly relevant. The practical implementation of the measures proposed in this publication will make it possible to increase both the fiscal and the regulatory effectiveness of the excise taxation of tobacco products in Ukraine.

1. Scientific approaches to the transformation of excise taxation of tobacco products in the paradigm of achieving the goals of fiscal consolidation and European integration

Specific excises are one of the primary budget-forming taxes and also play an important regulatory role in countries with developed and transformational economies. At the same time, the current trends in the reform of excise taxation show both the active use of fiscal opportunities for excise taxes (especially when the problem of the imbalance of public finances is exacerbated) and the gradual strengthening of their role in regulating the production and consumption of excisable goods¹. At the same time, these taxes are rather risky regarding the accumulation of tax revenues due to the specifics of the use of instruments of state regulation of the excisable goods market and the constant changes in the legislative field that affect the formation and implementation of excise policy. It is also important to note that specific excises can increase the financial resources of the state to overcome the negative effects of consumption of goods harmful from social, moral and environmental considerations if said revenue is allocated to the budget to compensate for the physical and psychological losses from such consumption.

For excise taxation of tobacco products, several features are typical. According to research by Western scholars, the price elasticity of demand on tobacco products is rather low (from 0.3 to 0.5), which serves as an argument in favor of strengthening the fiscal role of their excise taxation. The increase of excise rates does not significantly reduce the consumption of these excisable goods, which creates preconditions for increasing budget revenues. At the same time, the effectiveness of a fiscal-oriented excise policy largely depends on whether the following is taken into account: 1) the number of consumers and the corresponding consumption volumes by type of tobacco products; 2) the elasticity of demand for various types of these goods, taking into account the possibilities of increasing the

¹ Makarenko V. V. Global experience of application of individual excise taxes and prospects of its use in Ukraine. *Economy. Finances. Law*. 2010. No. 11. p. 12

volume of their illegal circulation and replacing consumption of some tobacco products with others (there may be a switching to the consumption of cheap alternatives, which leads to a loss of tax revenue)². Also, when raising excise tax rates, budget and health objectives should be balanced.

Despite the low elasticity of demand for tobacco products at the price change, in practice, it has been proved that with higher excise rates, budget revenue increases only to a certain point – the points of the fiscal optimum of the Laffer curve, after reaching which there is a decrease in the proceeds of this tax. At the same time, excise policy should focus not only on the "point of maximisation of tax revenues." It is also necessary to take into account the possible negative consequences of the spread of abuses in the field of collection of excise taxes, which generates, in particular, the demand of consumers with low incomes (it makes it economically attractive to use different tax evasion schemes). In order to prevent unwanted activation of such processes, it is often important to stop raising the tax rate without ensuring the accumulation of maximum excise duties. However, if the strengthening of the role of excise tax is highly effective in limiting tobacco use, then there is a sense in the next "motion" under the Laffer curve to maximise budget revenue, in spite of the risk of increased volumes of illegal production and the import of tobacco products³.

When forming an excise policy in the field of tobacco products, it is necessary, firstly, to approach the definitions of excisable goods and to establish excise duty on them; while the highest tax rate should apply to the most popular tobacco products. Secondly, it is important to ensure that the increase of excise rates is transformed into an adequate increase in budget revenue, and the excise tax system helps to restrict smoking. Thirdly, since the price elasticity of cigarette and other tobacco products demand is relatively low, there is the possibility of strengthening the fiscal role of their excise taxation, as long as the positive effect of increasing the excise taxes eliminates negative effects of such tax transformation

² Tobacco Taxation: Theory and Practice by Arthur B. Laffer, Ph.D. The Laffer Center at the Pacific Research Institute. San Francisco, 2014.

³ Ibid.

on the impact on macroeconomic processes. Fourthly, it is necessary to ensure a high level of efficiency of the system of administering the excise duties, which should promote the maximum collection of tax revenue without violating the rights of taxpayers and be as simple as possible for the latter⁴.

Since the EU and most countries throughout the world apply a mixed system of excise taxation on cigarettes based on a combination of specific and ad valorem rates, it is important to determine whether an increase of certain components of the excise tax would enable better achievement of the optimum in the paradigm "maximising budget revenue – creating favourable conditions for conducting legal business – reducing the smoking tendency".

Note that the predominance in the structure of the excise tax on cigarettes of a specific component in a fixed amount ensures stable revenue to the budget, which does not depend on price fluctuations. This improves the forecast of tax revenue and reduces the risk of increases in the budget deficit. In addition, taxation using specific rates is effective in achieving health objectives, since this approach provides the same level of tax burden on both cheap and expensive cigarettes, which contributes to the reduction of smoking without distorting the market and shifting the benefits between the goods of different price categories⁵.

Applying ad valorem rates makes it possible to accumulate additional revenue to the budget primarily due to the consumption of relatively expensive cigarettes, and therefore it is most effective in high-income countries. However, a high ad valorem rate may lead to the active consumption of cheap cigarettes, which negatively affects not only the excise tax but also VAT and income taxes.

⁴ Tobacco Taxation: Theory and Practice by Arthur B. Laffer, Ph.D. The Laffer Center at the Pacific Research Institute. San Francisco, 2014.

⁵ Balakin R. L. Excise taxation of tobacco products in member states of the European Union and in Ukraine. *Finansy Ukrainy*. 2007, No. 10, p. 102; Transformation of the Excise Policy of Ukraine: Monograph / Korotun V. I., Brekhov S. S., Novytska N. B. etc.; under gen. edition of V. I. Korotun. Irpin, 2015. p. 103, 111; Tax harmonisation in Ukraine under the terms of the Association Agreement between Ukraine and the EU: monograph / ed. A. M. Sokolovskoi; Kyiv, 2017. – p. 348; In the taxation of tobacco products, the focus should be on a specific part of the excise URL: <https://apostrophe.ua/news/economy/taxes/2018-06-04/v-nalogooblozhenii-tabachnyih-izdeliy-nujno-delat-aktsent-na-spetsificheskoy-chasti-aktsiza-ekspert/132074> <https://www.rbc.ua/rus/news/nalogooblozhenii-tabachnyih-izdeliy-nuzhno-1528177773.html>.

It should also be noted that according to the results of new expert studies⁶, for countries with predominantly ad valorem components in the structure of excise taxation of cigarettes, a relatively large spread of smoking is typical. Dependence is observed: the higher the level and weight of the role of the ad valorem rate, the greater the volume of consumption of these tobacco products. The fact is that relatively low specific and high ad valorem excise taxes create cheap price gateways for cigarettes, which increases the availability of these tobacco products.

Consequently, for countries with low incomes, such as Ukraine, it is important to increase the fiscal role of excise duty on cigarettes to focus on increasing the specific tax rate.

Despite the methodological correctness of these theoretical approaches, each country must find an answer to the question of what its excise policy should be and what the conditions for its successful implementation are. It would seem that it is necessary scientifically to substantiate and implement optimal changes in the use of the fiscal and regulatory potential of excise taxation, and the desired changes will quickly follow. But in practice, it is not just finding the optimum and achieving positive results in reforming tax mechanisms. Even in countries with a developed economy, changes in taxation often do not justify the expectations, and for Ukraine, the problem of avoiding numerous "pitfalls" on the path of developing an effective excise policy is very acute. This complicates the adoption of tax decisions and requires a heterogenous analysis of their impact on the institutional environment.

It is possible to distinguish, representing three dimensions of the institutional environment in the form of a pyramid: formal institutes (vertex), informal institutions, cultural traditions and values (foundation) (Figure 1.1). It is important to take into account the peculiarities of transformation of each of these levels.

Firstly, different levels of the institutional environment change at different speeds. The laws on increasing the rates of excise taxes on cigarettes for fiscal

⁶ Experts identified the taxes that stimulate smoking. RBC – Ukraine. URL: <https://www.rbc.ua/rus/news/uslozhnennyye-sistemy-nalogov-stimuliruyut-152769726.html>.

purposes, as well as adapting domestic taxation to harmonised EU standards and restrictions on tobacco smoking, can be adopted fairly quickly. At the same time, informal rules that support the spread of illegal tobacco business are significantly less likely to change (in order to achieve socially beneficial goals). The greatest inertia is typical of established traditions and values (fiscal mentality, the habit of smoking cheap cigarettes). They are not rebuilt after changes in formal norms and by the example of some, even very influential, economic actors. If the desired changes still occur, this process takes a lot of time. Still, no country has been able to significantly increase the revenue from excise tax on tobacco products, avoiding the curtailment of the legal production of these excisable goods, or radically reduce the smoking tendency.

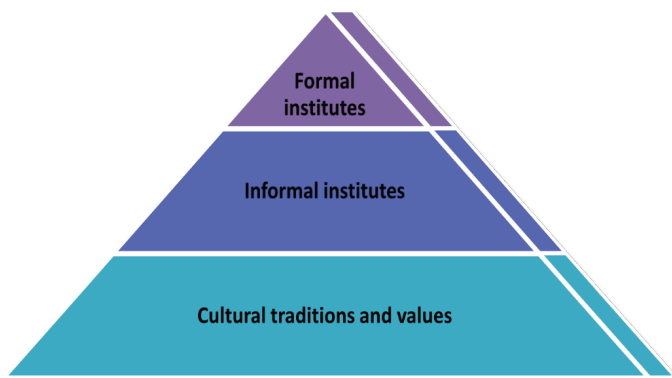


Figure 1.1. Levels of the institutional environment

Source: Williamson O. The New Institutional Economics: Taking Stock, Looking Ahe-AD. *Journal of Economic Literature*. 2000. Vol. 38, No. 3. P. 595–613.

Secondly, the instruments of influence at different levels of the institutional environment are also different. Laws on raising the rates of excise duties may, albeit with complications, be approved by Parliament. But in order to encourage economic actors not to reduce legal business activity (not to correct their informal behavioural schemes and business strategies), at least the improvement of control (persistent administrative support) and the preservation of profitable, legally operating tobacco companies in the market for a certain time period are required.

To influence the cultural layers, not even this is sufficient. It is also necessary to convince citizens that additional tax revenue is needed to increase budget expenditures on health care, reducing the attraction of new government loans; the purchase of cheap cigarettes, which offers an illegal market, reduces state revenues; smoking increases the risk of the appearance (exacerbation) of a number of dangerous diseases. This important role is given to mass media, which, however, can not quickly change the public opinion⁷.

Institutes are also not isolated from each other. The rules governing economic processes are closely intertwined. It is impossible to make large-scale changes in one sphere, without revising the consequences in adjacent ones. For example, it is possible to increase sanctions for violation of tax and special legislation, but if you do not improve taxation in general and the supervisory role of the state in the market in particular, it is useless to hope for improvement of tax discipline. The increase of excise rates without introducing measures to prevent abuse is associated with the risk of an increase in the illegal circulation of excisable goods with negative consequences for budget revenue. Or it is possible to reduce tax rates, but if not to optimise state expenditures and to compensate for fiscal losses by attracting significant amounts of government loans regardless of borrowing conditions, as neither dynamic GDP growth nor balancing public finances in the future should be expected. In the course of economic (tax) transformations, it is necessary to take into account the principle of institutional complementarity, according to which institutions complement each other and the desired economic (fiscal) effect can only be achieved on the basis of interconnected institutional changes⁸.

Changes in taxation often involve the transfer of financial resources of some economic agents to others; the former are usually perceived negatively and

⁷KuzminovYa., Radaev V., Yakovlev A., Yasin E. Institutions: from borrowing to cultivating (the experience of Russian reforms and the possibility of cultivating institutional changes). *Economic issues*. 2005. No. 5. p. 12.

⁸Amable B. Institutional Complementarity and Diversity of the Social System of Innovation and Production. Discussion Paper FS / 99-309, 1999. URL: <http://skylla.wz-berlin.de/pdf/1999/i99-309.pdf>.

blocked. The business sector is trying to prevent the adoption of laws to raise tax rates (the growth of tax exemptions is not offset by an equivalent increase in the consumption of public goods), and if this fails, it is looking for opportunities not to fully implement new fiscal obligations. As a result, the state loses tax revenues, which makes it impossible to finance additional expenditures without state borrowing (not always accessible due to limiting the budget deficit). Expenditures have to be adjusted according to actual tax revenue, other income and borrowed loans. Theoretically, optimal changes in redistributive processes do not occur. Actual GDP growth rates are lower than potential. The economic effect of tax (institutional) transformation is often completely or partially offset by the influence of the inertial mass of the entire institutional environment.

In view of the above, the institutional requirements for the formation and implementation of the state's excise policy are as follows:

1) *compromise*. It is necessary to balance the interests of the state, the business sector and citizens in such a manner that all these entities are comparably satisfied with the results of the GDP redistribution. It is necessary to accumulate the maximum amount of excise tax revenue, without inhibiting entrepreneurship; government expenditures (in particular, due to excise taxes) should provide the best combination of social measures and measures to promote economic growth and market transformations (in post-socialist countries),

2) *complementarity of tax changes*. Excise innovations should be consistent with other legislative norms, anticipate measures to influence the informal level of the institutional environment and positively evaluated by society. Moreover, in promoting unpopular changes in the excise it should be emphasised that inefficient tax mechanisms are harmful both from the point of view of social justice and pragmatic considerations. After all, by slowing down GDP growth, they even turn against those who initially received a profit from them;

3) *rejection of radical tax initiatives* that create a threat of fiscal losses (instead of a positive economic effect and an increase in state revenue) as a result of an impossible quick response to them by economic actors. The reform of the

excise taxation of tobacco products should be carried out not by the "big jump" method, but gradually, simultaneously with changes in the institutional environment;

4) *stability and flexibility*. Excise policy should, on the one hand, be consistent with certain strategic directions of modification of excise taxation, on the other hand – to respond quickly to changes in socio-economic and fiscal processes.

In addition, the importance of reforming excise taxes in Ukraine in general and tobacco products in particular is to take into account European integration tasks and priorities. The EU Association Agreement, which fully came into force on 1 September 2017, is the first step towards deepening economic cooperation with the European Union, which obliges Ukraine's tax legislation to be adapted to the specific provisions of a number of EU directives and sets a timetable for such. Our country does not have a prospect of joining the European Union, and therefore the need to ensure full compliance of national tax laws with the harmonised tax rules of the EU is not like to arise soon. In addition, the Association Agreement states that Ukraine should take measures to prevent tax evasion, including on counteracting the smuggling of excisable goods, but such measures are not specified. It updates the assessment of the norms of the Tax Code of Ukraine regarding the excise taxation of tobacco products in the context of EU directives, which are specified in the Association Agreement.

According to Annex XXVIII of Chapter 4 "Taxation" of Section V "Economic and Industrial Cooperation", the Association Agreement between Ukraine and the European Union ⁹must necessarily bring the legislation of our state closer to the specific provisions of the EU directives governing the excise taxation of tobacco products, in particular:

1) Article 1 of Council Directive 2008/118/EU of 16 December 2008 on general conditions for the charging of excises and repealing Council Directive

⁹ The Association Agreement between Ukraine, on the one hand, and the European Union, the European Atomic Energy Community and their member states, on the other hand, dated 21 March, 27 June 2014.– URL: http://www.kmu.gov.ua/control/publish/article?art_id=246581344.

92/12/EEC (within 2 years from the date of entry into force of the Agreement);

2) Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duties on tobacco products (codification) within 2 years from the date of entry into force of the Agreement (except for Articles 7(2), 8, 9, 10, 11, 12, 14(1), 14(2), 14(4), 18, 19 for which the implementation schedule will be established by the Association Council later).

The rest of the provisions of the aforementioned and other directives and legislative acts of the European Union on excise taxation of tobacco products may be taken into account by Ukraine when making amendments to national legislation if it deems such appropriate. In addition, it is important to study the experience of the European Union countries in the administration of excise duties (mechanisms and procedures that are regulated not by common EU legislation, but by national tax legislation) for the possibility of its implementation in domestic socio-economic realities.

On 1 November 2014, the temporal application of a number of provisions of the Association Agreement began, including Annex XXVIII to Chapter 4 "Taxation", of Section V "Economic and Industrial Cooperation"¹⁰. This means that the two-year implementation period in Ukraine of the two directives mentioned above expired on 1 November 2016. Therefore, we prioritise the issues of compliance with the provisions of the Tax Code regarding excise taxation of tobacco products to the norms of the EU directives, the timetable for implementation of which has been established.

Article 1 of Council Directive 2008/118/EU of 16 December 2008 on the general provisions for excise duty and repealing Council Directive 92/12/EEU¹¹ identified groups of "harmonised" excisable products and directives governing their excise duty taxation (paragraph 1), namely:

- energy products and electricity (Council Directive 2003/96/EU);

¹⁰ Temporary application of the Association Agreement between Ukraine and the EU. URL: http://www.kmu.gov.ua/control/uk/publish/article%3f=1&art_id=247667894&cat_id=223223535.

¹¹ The general arrangements for excise duty and repealing Directive 92/12/EEU: Council Directive of 16 December 2008 – (2008/118/EU). URL: <http://www.minjust.gov.ua/45885>.

- alcohol and alcoholic beverages (Council Directives 92/83/EEU, 92/84/EU);
- tobacco products (Council Directive 2011/64/EU).

The text of Council Directive 2008/118/EU when it was adopted stated that the excise tax on tobacco products is regulated by Council Directive 95/59/EU, Council Directive 92/79/EEU and Council Directive 92/80/EU. Subsequently, the provisions of these directives were transposed into Council Directive 2011/64/EU, and they became null and void (references to them should be taken as references to Council Directive 2011/64/EU).

Article 2, paragraph 1, provides that it is possible to tax "harmonised" excisable goods with other indirect taxes for special purposes (provided that such taxes are in accordance with mandatory Community rules applicable to special taxes, don't have any VAT features for determining the tax base, rates taxation, tax liability, and control). In addition, according to Clause 3 of Art. 1 Council Directive 2008/118/EU, other taxes may apply to other goods, services, in particular those related to "harmonised" excisable goods. This means that it is possible to tax excise goods that do not belong to the harmonised categories "energy products and electricity", "alcohol and alcoholic beverages" and "tobacco products".

In Ukraine, as in European Union countries, an excise tax on tobacco products is levied. We will later return to the issue of compliance of our country's tax legislation with Articles 2 and 3 of Article 1 of Council Directive 2008/118/EU.

Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duties on tobacco products (codification)¹² defines the basic principles for the harmonisation of the structure and rates of excise duty on tobacco products (processed tobacco).

According to Articles 3-5 of the Directive, processed tobacco is defined as

¹² About the structure and rates of excise duties applicable to tobacco products (codification): Council Directive of 21 June 2011 (2011/64/EU). URL: <http://www.minjust.gov.ua/45885>.

follows:

- cigarettes (rolled tobacco that can be smoked as is and which are not cigars or cigarillos, rolled tobacco, which, through simple non-industrial processing, is filled into tubes of cigarette paper; rolled tobacco, which, by simple non-industrial processing, is wrapped in cigarette paper);

- cigars and cigarillos (rolled tobacco with an outer wrap of natural tobacco; rolled tobacco with a blended filter and with an outer wrapper of the normal colour of a cigar; a recovered tobacco which completely covers the product, including, if necessary, a filter, but not, in relation to the exacerbated cigars, the sharp end, if the mass, not including the filter or mouthpiece, is not less than 2.3 g and not more than 10 g, and the circumference of at least one third of the length is not less than 34 mm);

- tobacco for smoking: 1) finely chopped tobacco for rolling in cigarettes (tobacco that was cut or otherwise crushed, twisted in the form of bundles or pressed into blocks and which can be smoked without further industrial processing); 2) other tobacco smoking (tobacco residues, packaged for retail trade, which are not cigarettes, cigars and cigarillos and can be smoked; tobacco remains are tobacco leaves and by-products from tobacco processing or tobacco production).

Article 7 (1) of the Directive states that the following applies to cigarettes: 1) ad valorem excise duty as a percentage of the maximum retail price, taking into account all taxes (the duty may be disregarded); 2) specific excise duty, set per unit of product. The maximum retail price is determined by the manufacturer or importer of cigarettes.

The ad valorem and specific excise rates should be the same for all types of cigarettes (Article 7(2) of the Directive) and the percentage of the specific component of excise duty in the total tax burden on cigarettes should be determined on the basis of the weighted average retail selling price (Article 8(1) of the Directive). This price is calculated by dividing the total cost of all manufactured cigarettes in the previous year (taking into account their maximum

retail price including all taxes) on their total quantity (Article 8(2) of the Directive).

Pursuant to Article 8(4) of Council Directive 2011/64/EU, the specific excise duty should not be less than 7.5% and more than 76.5% of the aggregate tax burden (VAT + ad valorem + specific excise duty). Moreover, before the entry into force of this Directive in 2012, on the territory of the EU, there was a norm that set such "framework" standards at 5% and 55% respectively. The above indicates approval of the European practice of establishing an excise tax on cigarettes, in which the specific component would dominate, which, as noted, not only ensures stable budgetary revenue but is also more effective in achieving health objectives.

It is possible to apply a minimum excise tax on cigarettes (Article 6(8) of Council Directive 2011/64/EU). In Article 10(2), the Directive states that the total excise duty on cigarettes should be at least 60% of the weighted average retail selling price. At the same time, this amount must not be less than EUR 90 per 1,000 cigarettes, regardless of the weighted average retail selling price. EU countries charging excise duty of at least EUR 115 per 1,000 cigarettes are not required to comply with the requirement of the aforementioned 60%.

As already mentioned, a term of implementation in Ukraine of Articles 8-10 of Council Directive 2011/64 /EU has not been established.

As for cigars, cigarillos and tobacco for smoking, Ukraine's compliance with Article 14(3) of the Directive on excise rates to be set without distinction within each group in terms of quality, presentation, origin of products, materials used in their production, characteristics of the manufacturer, etc. is already obligatory.

The Directive also provides that rates for these tobacco products may either be ad valorem (calculated on the basis of the maximum retail price) or set at a fixed amount per kilogram (for cigars and cigarillos, for a fixed amount for a certain number of units of production); or to combine ad valorem and specific components. If applying ad valorem or mixed rates to cigars, cigarillos and smoking tobacco, a minimum amount of excise duty may be set. The excise duties should be as follows: for cigars or cigarillos, not lower than 5% of the retail selling

price, including all taxes, or EUR 12 per 1,000 units or per kilogram; smoked tobacco intended to roll cigarettes – not lower than 48% of the weighted average retail selling price or EUR 60 per kilogram (from 1 January 2018); other smoking tobacco – not lower than 20% of the retail selling price, including all taxes, or EUR 22 per kilogram. A term of implementation in Ukraine of the provisions of Council Directive 2011/64/EU has not been established.

Article 15 of the Directive, the observance of which is now obligatory for our state, enshrines the right of manufacturers and importers of tobacco products to freely set the maximum retail prices for them.

In accordance with the provisions of subs. 215.3.2 of the Tax Code in Ukraine, excisable goods in the context of tobacco products, tobacco and industrial tobacco substitutes are as follows: 1) tobacco raw materials and tobacco waste (code according to UKT ZED 2401); cigars and cigarillos (code according to UKT ZED 2402100000); 2) cigarettes with a filter and without a filter (code according to UKT ZED 2402209020 and 2402209010); 3) tobacco and tobacco substitutes, other of industrial production, "homogenised" or "recovered" tobacco, tobacco extracts and essences (code according to UKT ZED 2403). Not all of this tobacco production is considered "harmonised" excisable goods. In particular, Council Directive 2011/64/EU does not regulate the taxation of excise duty on tobacco products, tobacco wastes and non-smoking tobacco products (from the list covered by the code UKT ZED 2403, "smoking tobacco" is only smoking tobacco, including those containing tobacco substitutes in any proportion). Therefore, it is necessary to amend the Tax Code regarding the structure of excisable goods of this group – separation of "harmonised" tobacco products, guiding their definitions¹³. According to the Association Agreement, this was to be done by 1 November 2016. In addition, the relevance of separation of "harmonised" tobacco products (with the division into categories provided by the Directive) and "non-harmonised"

¹³Koshchuk T. V. Adaptation of the tax legislation of Ukraine regarding the collection of excise taxes to the EU directives. *Scientific works of NDFI*. 2015. No. 3. pp. 55–56; Tax harmonisation in Ukraine under the terms of the Association Agreement between Ukraine and the EU: monograph / ed. A. M. Sokolovska; State Educational and Scientific Institution "Acad. finn. management". Kyiv 2017 pp. 329, 336–337.

tobacco products, raw materials and waste will be strengthened in establishing the term of implementation in Ukraine of all provisions of the Directive on types of tax rates (not only for cigarettes) and their minimum size.

According to paragraph 214.1 of the Tax Code, the basis of taxation of excise tax using ad valorem rates is the value of the goods at the maximum retail prices, including VAT and excise taxes. Until 2016 The VAT was not taken into account, which contradicted Article 7(1) of Council Directive 2011/64/EC.

It should also be noted that by 2011 the ad valorem component of the excise duty on manufactured tobacco products in Ukraine was calculated on the basis of the producer's wholesale price (excluding VAT and excise duty) and for imported products – based on the maximum retail prices set by the importer (also without VAT and excise duty collection)¹⁴. Accordingly, with the adoption of the Tax Code, a step has been taken towards approximation of the domestic excise taxation of tobacco products to the EU standards.

In Ukraine, the maximum retail prices for excise goods are set by producers or importers by declaring such prices (paragraph 220.1 of the Tax Code). This provision is in line with the provisions of Council Directive 2011/64/EU. At the same time, since 2016, it was not enough to enter into force the provisions of the Tax Code, according to which the Government was given the authority to establish minimum wholesale and retail prices for tobacco products, tobacco and industrial substitutes. This provision is contrary to the requirements of Article 15 of Council Directive 2011/64/EU on the freedom to determine the maximum retail price¹⁵ and therefore not applicable. An issue for Ukraine is the development of an anti-dumping mechanism for securing excise tax and cigarette VAT revenues from reductions based on European experience (this issue is discussed in Sections 2, 4).

The percentage of the domestic specific component of the excise tax in the aggregate tax burden on cigarettes is not determined based on their weighted

¹⁴Balakina R. L. Excise taxation of tobacco products in member states of the European Union and in Ukraine. *Finansy Ukrainy*. 2007, No. 10. p. 108.

¹⁵Sokolovska A. M. PodatkoviaspektyYeS acquis yak oriientyryvdoskonalenniaaktsyznohopodatku v Ukraini [EU tax acquis aspects as a guide for improving excise tax in Ukraine]. *Finansy Ukrainy*. 2016. No. 12. 30-31 p.

average retail selling price. This price is not calculated today. Despite the fact that with the introduction of such a complex calculation in our state, it was possible not to rush (the deadline for the implementation of the relevant provisions of the Directive has not been set), in 2018 the amendments to the Tax Code came into force, according to which the application of the weighted average retail price of cigarettes sales will start from 1 January 2025.

In Ukraine, excise duty rates for filtered and non-filter cigarettes are mixed and identical (from 2015), while cigars, cigarillos and other smoking tobacco are specific and not differentiated (this corresponds to the provisions of Council Directive 2011/64/EU). Paragraph 215.3.3 of the Tax Code establishes a minimum excise tax liability for the payment of excise taxes on cigarettes. At the same time, with the adoption of the Tax Code, there was a shift from the application of this obligation as a percentage of the maximum retail price (excluding VAT and excise duty) until it was established in a fixed amount as regulated by the Directive.

The rates of excise duty on cigars, cigarillos and other smoking tobacco in Ukraine are higher than the minimum rates of excise duty imposed by the Directive. As of 1 January 2018, the domestic excise tax rate for cigars and cigarillos is UAH 726.15 (in euros at the rate of the NBU as of 10 July 2018, 1:30.6 – 23.7 euros) per kilogram, which is almost two times lower than the corresponding minimum rate in the European Union at EUR 12 per kilogram. The rate of excise duty on other tobacco for smoking in Ukraine – also UAH 726.15 per kilogram – EUR 1.7 exceeded the minimum level in the EU – EUR 22.

Since the weighted average retail selling price of cigarettes in Ukraine is not calculated, it is difficult to compare the ratio of the specific and ad valorem components of excise duties, VAT with the relevant "framework" standards of the European Union. However, if we assume that in Ukraine in 2018, the weighted average retail price of cigarettes sales (to be calculated on the basis of data on the prices and volumes of sales of these excisable goods in 2017) in the amount of a

pack is UAH 24¹⁶, the aggregate tax burden in this amount forms: UAH 4 of VAT; UAH 11.56 of specific and UAH 3.90 of ad valorem component of the excise tax¹⁷. Under such conditions, the specific component of the excise tax in the aggregate tax burden on cigarettes is 59.4%. This indicator is significantly lower than the EU threshold of 76.5%. Therefore, in the case of establishing the deadline for the implementation of Article 8 of Council Directive 2011/64/EU in domestic law, Ukraine will not be obliged to adjust the ratio of the specific and ad valorem component of the excise tax by increasing ad valorem.

The minimum excise tax liability for excise duty on cigarettes in Ukraine (on 1 January 2018 – UAH 772.2, or EUR 25.2 per 1,000 pieces) is more than 3 times smaller than the corresponding minimum of EUR 90 in the EU. Assuming the average weighted retail price at the level of UAH 24 per pack of cigarettes, the share of total load of excise tax (UAH 15.46) in it equals 64.41%. This is more than the corresponding minimum level in the EU of 60%. Since Ukraine is not bound by the requirements of Art. 10 of Council Directive 2011/64/EU, domestic excise tax rates for cigarettes can be increased gradually, given the risk of increased smuggling, shadow production and sales, without trying to approach the European Union standard of EUR 90 for the "big jump".

It should also be noted that in 2015 Ukraine introduced an excise tax on the retail sale of excisable goods. This tax is credited to local budgets. Despite the fact that Article 1 of Council Directive 2008/118/EU states that it is possible to tax "harmonised" excise goods with other indirect taxes (paragraph 2) and services for the sale of excisable goods (paragraph 3), this retail tax in Ukraine has no legally established purpose and is not a tax related to the service of sale of excisable goods (there is a contradiction with the requirements of the Directive). In addition, such a measure does not correspond to the need to raise the rates of domestic "standard"

¹⁶ In case of adoption of the law on raising tobacco excise duty to the EU level, average prices for cigarettes in 2018 can grow by 25% – up to UAH 30 per pack. URL: <https://press.unian.ua/press/2259281-seredni-tsini-na-sigareti-u-2018-rotsi-v-razi-priynyattya-zakonu-pro-pidvischennya-tyutyunovogo-aktsizu-dorivnya-es-mojut-zrostiti-na-chvert-do-30-grn-za-pachku-eksperti-foto-video.html>.

¹⁷ In 2018, the excise tax on cigarettes exceeds the minimum excise tax liability for a pack (UAH 15.46), if the price of the pack is more than UAH 32.5. Only beyond this price level does the ad valorem excise duty accrue at a rate of 12%.

excise tax for a number of "harmonised" excisable goods to a level not lower than the corresponding minimum rates in the EU. Therefore, it is necessary to abandon the excise tax on retail sales in favor of raising the rates of "standard" excise tax.

In addition, it is necessary to consider the possibility of implementation of a number of provisions of Council Directive 2008/118/EU in the tax legislation of Ukraine (in the long run), which are not mentioned in the Association Agreement but serve as an instrument for preventing abuses in the payment of excise duties. This is in particular the gradual preparation of institutional infrastructure for the introduction of excise warehouses for tobacco products (in accordance with the requirements of Articles 15 and 16 of the Directive) and an electronic system for monitoring the movement of excisable goods under deferred taxation (Article 21 of the Directive), which provide for the possibility of payment of excise duties at the sale of excisable goods for consumption (Article 7 of the Directive). In Ukraine, since 2013, the excise tax on tobacco products has been paid when purchasing tax stamps, which diverts the circulating capital of tobacco companies. In 2017, the opportunity was given to pay excise duty within five days after the purchase of tax stamps; in 2018 this term increased to fifteen days. But such measures only partially solved the problem of paying excise taxes until the beginning of the production of tobacco products. At the same time, with the increase of excise tax rates for tobacco products, which will increase incentives for tax evasion, the relevance of the transition to a European excise administration practice based on the requirements of Council Directive 2008/118/EU will increase.

2. Current trends in the development of taxation mechanisms for tobacco products in EU countries

The current EU legislation on excise taxation on tobacco products creates a large number of options for both the total excise tax rate and the structure of excise and the level of retail prices for tobacco products. The overall transformation of tobacco taxation approaches in the EU operates within the framework and taking into account the measures to harmonise national legislation and the approximation

of EU Member State legislation to the provisions of the special directives. However, it should be noted that tax regulation falls within the competence of every EU member state. The first directive on taxation of tobacco products was adopted in 1972. This Directive introduces the use of a mixed structure of specific and ad valorem taxation with a specific excise tax on tobacco products. The main purpose of its adoption was the introduction of equal competitive conditions among manufacturers of EU member states, as well as the provision of the free movement of goods within the EU. In addition, the specificity of the Directive was the introduction of a new concept – the minimum excise tax (hereinafter – MET) in tax practice. The definition of this indicator was provided by using two methods: as a percentage of excise tax on cigarettes of the most popular price group or as a fixed amount. If characterised by country, the method of establishing MET in the form of interest was used by the countries of "old" Europe and in the form of a fixed amount – by the countries of Eastern Europe. The dimensions of MET also varied depending on the national characteristics of the EU member states¹⁸. The use of the MET indicator allowed the governments of the countries to implement measures for the proactive administration of excise taxes aimed at preventing budget losses from non-payment of taxes through the use of tax incentives by tax entities, including via the manipulation of prices for certain types of tobacco products. The result of the use of MET in the EU countries was the adoption of Council Directive 2002/10/EU, which expanded MET to the following extent: "Member States may impose a minimum excise duty on cigarettes sold at a lower price than the retail price of cigarettes in price groups most in demand, provided that the specified excise duty does not exceed the excise tax on cigarettes of the price groups most in demand"¹⁹.

The Directives on convergence of excise rates provided that the rates were to be reviewed every three years until 2002 and then every four years. The basis for

¹⁸ Transformation of Excise Policy in Ukraine: monograph / Korotun V. I., Brekhov S. S., Novytska N. B. etc.; under gen. edition of V. I. Korotun. Irpin, 2015. p. 109.

¹⁹ The tobacco taxation system in Ukraine: ways to approach the requirements of the European Union (scientific and practical research). URL: www.ir.org.ua. p. 111.

the decision on this issue was the report of the European Commission assessing the adequacy of the system of excise tax treatment of tobacco products and assessing the impact of the applicable requirement on the size of MET.

With the adoption of Council Directive 2011/64/EU, new changes have been made to the harmonised EU standards for excise taxation of tobacco products. The relevant provisions of the common European law applicable today are described in Section 1.

Having examined the EU legislation on excise taxation, it should be noted that the level of excise tax use affects the volumes of production and consumption of certain groups of excisable goods, the structure of production and indirectly contributes to qualitative changes in the structure of the market for excisable goods²⁰. In addition, its use makes it possible to regulate the level of profitability of activities related to operations subject to excise tax. Note that there is a tendency in the EU countries to increase revenues from tobacco excise duties, which is the result of the gradual increase of excise tax rates in most EU countries. In 2012-2017, the share of this tax in total tax revenues fluctuated slightly during the analysed period and averaged 1.8%, while consumption taxes accounted for about one fifth (Figure 2.1).

By analyzing the tax revenues from tobacco products in 2017, in terms of EU member states, one can see that the top five of the leaders are those with the largest population, namely Poland (EUR 4.5 billion), Spain (EUR 6.7 billion), Italy (EUR 10.5 billion), France (EUR 11.5 billion), Germany (EUR 14.4 billion). Ukraine is at the level of countries such as Bulgaria and Portugal, with an indicator of corresponding revenue at the level of EUR 1.2 billion. But after examining the volume of tobacco tax revenue per consumer (Figure 2.2), it can be seen that the highest rates in 2017 were in Finland (EUR 839.01/year), Slovenia (EUR 916.06/year), Denmark (EUR 932.02/year), Ireland (EUR 1,197.02/year) and Luxembourg (EUR 3,855, 27/year).

²⁰Zhukevich O. M. Transformation of Excise Taxation of Tobacco Products in Ukraine. *Bulletin of the Zhytomyr State Technological University*. 2012. No. 1 (59). p. 259.

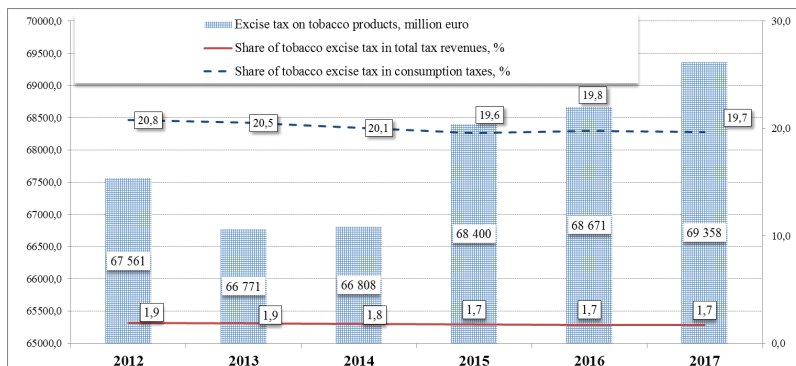


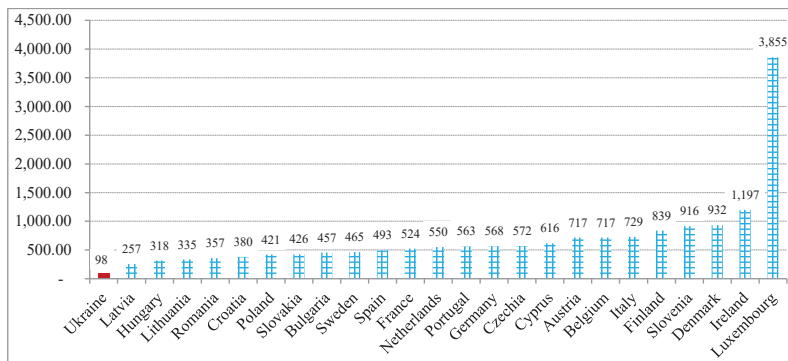
Figure 2.1. Trends in the share of excise tax on tobacco products in taxes on consumption and total tax revenue in EU countries, %

Source: compiled by the authors on the basis of data: Excise Duty Tables Tax receipts – Manufactured Tobacco. European Commission. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties_tobacco_en.pdf ra Eurostat.

It is worth noting that the tax burden on cigarettes depends on factors such as the structure of excise tax rates, that each country has its own characteristics, living standards and income per capita, efficiency of tax administration.

Today, EU countries can be divided into several groups regarding the level of taxation of tobacco products, depending on the excise tax component in the price of sales of tobacco products (per 1,000 pieces):

- with a high level of taxation (more than EUR 150) – Germany, Denmark, Sweden, Belgium, the Netherlands, Finland, France, Ireland;
- average (EUR 100-149) – Czech Republic, Latvia, Slovenia, Luxembourg, Cyprus, Portugal, Spain, Italy, Austria;
- low (less than EUR 99) – Bulgaria, Croatia, Hungary, Romania, Poland, Lithuania, Slovakia.



**Figure 2.2. The tax burden of excise tax on tobacco products
in the EU and Ukraine in 2017²¹**

Source: calculated on the basis of data: Excise Duty Tables Tax receipts – Manufactured Tobacco. European Commission. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties_tobacco_en.pdf; Excise Duty Tables Part III – Manufactured Tobacco. European Commission. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf; Current smoking of any tobacco product (age-standardised rate). World Health Organization. 2018. URL: <http://apps.who.int/gho/data/node.wrapper.imr?x-id=346>.

In countries with income per capita above the average EU-17, the total taxation of tobacco products in the most popular price category is 3 times higher than the retail price without taxes. In addition, all countries in this group of EU member states meet the minimum excise duty of EUR 90 per 1,000 cigarettes and the relative excise duty level of 60% of the weighted average retail price.

Taking into account the requirements of Council Directive 2011/64/EEU in the EU countries, a mixed system of taxation of tobacco products is applied. The choice between the structure of the component rates is carried out in accordance with the characteristics of the national market for such products.

The predominance of a specific or ad valorem component in the excise duty indicator depends on the country's strategy in taxation of tobacco products. After all, the specific and ad valorem rates of excise tax have a different effect on prices,

²¹ The indicator of the tax burden of the excise tax on 1 consumer of tobacco products, the amount in euro per year is calculated as the amount of tax revenue from the excise tax, divided by the number of smokers and the tax burden of excise tax on 1,000 pcs. cigarettes (*excise yield*) – the amount of tax revenues from excise taxes of 1,000 pcs. tobacco products, determined on the basis of their weighted average retail price.

profits, tax revenue, quality and variety of goods, methods of administration and distribution of income. The European Commission supports the application of specific rates of excise duty since they are the best tool for restricting consumption of tobacco products, do not require harmonisation between governments and producers of retail prices and, accordingly, do not violate the principles of a free market.

It should be noted that the ad valorem component of the excise tax on tobacco products at their prices prevails in such EU member states as Austria, Belgium, Luxembourg, France, Spain, Italy, Finland, and varies from 38% in Austria to 52% in Finland (Figure 2.3). The choice of this structure of interest rates is determined by the high level of GDP per capita in these countries. Since consumers with higher incomes usually choose premium-grade cigarettes with high quality and, accordingly, a price that has a positive impact on tax revenue.

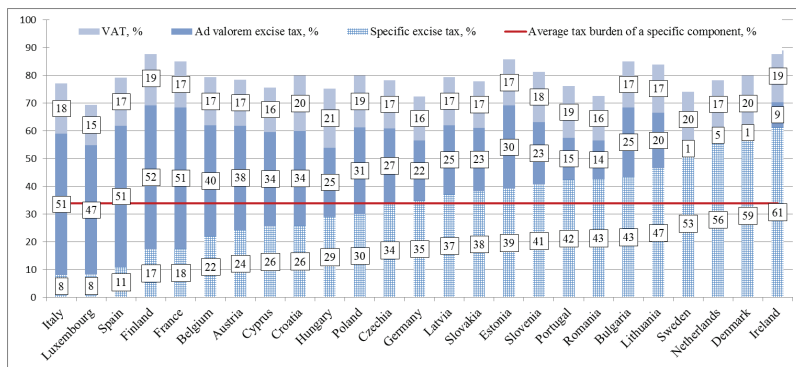


Figure 2.3. The tax burden on cigarettes in the EU member states as of 1 July 2018, % to average weighted price

Source: compiled by the authors on the basis of data: Excise Duty Tables Part III – Manufactured Tobacco. World Health Organization. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf.

As a rule, a specific component of the excise tax is preferred by countries with a high level of cigarette consumption or with a tight policy of reducing

tobacco smoking. These include: Slovakia (4,303.3 pcs./1 smoker²²), Slovenia (7,844.7), Portugal (4,530.7), Romania (3,987.5), Bulgaria (5,173, 8), Lithuania (3,440.5), Sweden (2,855.4), the Netherlands (2,244.4), Denmark (5,858.1) and Ireland (3,081.4). In these countries, the specific component in the price of tobacco products exceeds the average value for EU countries.

For a long time in the EU countries, along with harmonisation processes, a strategy has been implemented aimed at increasing the share of excise tax in the price of sales of a unit of tobacco products. Simultaneously with the restriction of the level of consumption of such goods, an increase in the level of excise tax makes it possible to achieve an increase in the level of tax revenue to the budget with minimal expenses for its administration. It should be noted that the consumption of cigarettes in the EU countries in recent years has decreased by 15% – from 553.4 billion in 2012 to 471.5 billion pcs. in 2017 (Figure 2.4).

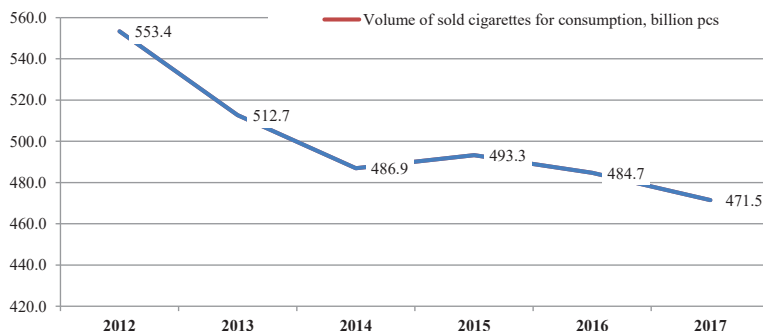


Figure 2.4. Trends of volume of sales of cigarettes for consumption in EU member states during 2012–2017

Source: compiled by the authors on the basis of data: Releases for consumption of cigarettes 2002–2017 (in 1,000 pieces). European Commission. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/tobacco_products_releases-consumption.pdf.

Despite the effectiveness of the excise policy on reducing tobacco consumption, many EU countries, in addition to problems of smuggling and

²² Hereafter the level of sales of cigarettes for consumption pcs. for 1 person who smokes.

counterfeiting, faced the problem of optimising the payment of excise tax on tobacco products - forestalling (warehousing of tobacco product makers with tax stamps purchased before the raising of rates), which hinder the full realisation of the fiscal and regulatory potential of excise taxation. There is an increase in the volume of production of excisable products before increasing the excise tax rates in order to minimise the payment of tax liabilities in future periods. Consequences of such a negative phenomenon are the non-receipt of the excise tax to the budget, as well as distortion of competitive conditions on the market.

This problem is significant for most EU countries, which have introduced in response the most appropriate anti-forestalling measures depending on the specifics of the excise tax system and the control of the circulation of excisable goods in each country. Thus, according to the European Commission, about 70% of the Member States are applying anti-forestalling measures. Such measures are divided into four types²³:

1) *the establishment of quotas regarding the number of tax stamps issued*²⁴ (*cap on tax stamps*) (used in Bulgaria, Belgium, Denmark and Luxembourg). For example, in Denmark between November and December of the reporting year, this quota is 120% of the average monthly volume of tax stamps ordered in previous months. In the case of exceeding the quota, the excise tax is paid at rates that will apply from January of the following year;

2) *limitations on volumes of tobacco products that can be released for consumption (cap on release for consumption)* (used in Luxembourg, Portugal, the United Kingdom, Cyprus and Malta). For example, British companies have restrictions on the release of cigarettes for consumption from 1 January until the date of the announcement of changes in excise tax rates). In Portugal, there are restrictions on the number of cigarettes issued from 1 September to 31 December, calculated on the basis of 110% of the average monthly rate over the previous 12 months. In Malta, a similar measure is used, but without an adjustment coefficient

²³ Some member states are mentioned twice since the system applied can combine the standard methodology and additional measures in certain circumstances.

²⁴ The cost of the tax stamp in most EU countries is included in the excise tax.

for the possible positive market trends;

3) *establishment of a sale date (sell-by date):*

3.1) *in wholesale trade (sell-by date at wholesale)* (used in Belgium, Hungary, the Netherlands);

3.2) *in wholesale and retail trade (sell-by date at retail)* (used in Estonia, Poland, Portugal, Slovakia). Such a measure provides for restrictions on the timing of the sale of tobacco products at certain tax rates. In Estonia, when a new excise tax rate is introduced, goods may be sold within three calendar months after the date of the new rate. Hungary has a similar policy where wholesalers must sell their products within 15 days of the announced date. In the Netherlands, manufacturers, wholesalers and importers can sell tobacco products with the "old" excise stamp within two months after the introduction of a new excise rate, but these measures do not apply to retailers. Finally, in Poland, the "old" tax stamps are valid only in the current calendar year and can be used until the last day of February of the following year;

4) *recalculation of tax obligations on excise tax on the date of actual sales of products to the consumer (paying the tax difference)* (used in Croatia, Denmark, France, Latvia, Lithuania, Slovenia). In Lithuania, this measure applies only to cigarettes still at wholesale traders, while in Latvia and Slovenia, the recalculation of tax liabilities is based on the inventory of tobacco product stocks at all levels of trade²⁵.

In some European countries, such as Belgium, Luxembourg, Portugal, Denmark, several measures are used simultaneously to increase the effectiveness of anti-forestalling regulation. A detailed description of these measures, their consistency with the EU Excise Duty Directives, the adaptability to the taxation systems of the EU Member States, the convenience of administration and control (including fiscal effects, cost of implementation, etc.), the impact on the

²⁵ Study on the measuring and reducing of administrative costs for economic operators and tax authorities and obtaining in parallel a higher level of compliance and security in imposing excise duties on tobacco products. European Commission. 2014. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ramboll-tobacco-study.pdf.

functioning of the market are specified in Annexes A and B.

It is worth noting that some countries did not immediately identify the best anti-forestalling measures, but chose them on the basis of achieving the goal of equalising tax revenues throughout the year. Thus, in Poland, before the introduction of measures, the excise tax revenues were uneven throughout the year, their coefficient of variation was 71.1%. From March to May, revenues were significantly lower than in other tax periods and from December to February – significantly higher (Table 2.1). In order to counteract this phenomenon, in 2009 a norm was introduced on the final date for the sale of tobacco products at all levels of trade, which was 6 months (end of June). Such measures did not have a proper impact on forestalling. Excise tax revenues were also unstable during 2009, but their variability decreased, while the coefficient of variation dropped to 66.4% and already in January 2010, this deadline was reduced to 2 months (end of February). These measures proved to be effective, as a result of their introduction, the excise tax was equalised during the year, the coefficient of variation dropped to 14.9% in 2010 and to 12.1% in 2011, which is evidence of low variation in tax revenues.

Table 2.1

Influence of anti-forestalling measures on the uniformity of excise tax revenues from tobacco products in certain EU countries

Item no.	Country	Coefficient of variation,%		
		Before implementing the measure	After the first stage of anti-forestalling regulation	After the second stage of anti-forestalling regulation
1	Poland	71.1	66.4	14.9
2	Slovakia	178.4	32.4	21.2
3	Belgium	34.8	-	16.1

Source: calculated on the basis: Tusveld R., Lejeune I., Bogaerts N. Study on fiscal anti-forestalling measures for the tobacco sector. PWC. 2013. 28 p.

The trends of the tax revenue of the excise tax on tobacco products in Slovakia, without the measures of anti-forestalling regulation of revenues, was similar to that observed in Poland, the coefficient of variation was 178.4%. Anti-

forestalling measures were introduced on 1 February 2009, in the form of the establishment of a final date of implementation at all trade levels of 9 months (end of October), but revenue also had a high level of variability. Since February 2011, the date has been reduced to two months (coefficient of variation – 32.4%), and from February 2012 to one month (coefficient of variation – 21.2%). Consequently, only anti-forestalling measure of the last kind permitted to ensure the regularity and low variation of the tax revenue of the excise tax on tobacco products in Slovakia.

In Belgium in January 2012, several anti-forestalling measures in the form of quotas on tax stamps and final sales dates of up to 3 months after the increase of excise tax rates were applied at the same time, which enabled a reduction in the variability of tax revenue from 34.8 to 16.1%. The number of marks that could be obtained was calculated on the basis of the average monthly indicator of the past year increased by 15%.

It should be noted that according to expert opinions²⁶, of all the above anti-forestalling measures the most effective is a measure of type 3a, as its application:

1) complies with the EU Excise Duty Directives, does not depend on the taxation system and does not require the recalculation of obligations or use of the reference period, ensures the stability of tax revenues throughout the year;

2) does not depend on the system of labeling of tobacco products and does not involve additional expenses for tax administration and control over the circulation of excisable goods, does not distort market conditions.

Also, we will focus on other points. Since the excise tax on tobacco products is traditionally used as a tool to fill the budget with a relatively small negative impact on macroeconomic dynamics, under adverse conditions it is often subject to adjustments to overcome the imbalance of public finances. At the same time, the strengthening of the fiscal role of excise tax on tobacco products is a means of limiting cigarette consumption harmful to health. However, especially when

²⁶Tusveld R, Lejeune I, Bogaerts N. Study on fiscal anti-forestalling measures for the tobacco sector. PWC. 2013. 28 p.

raising excise tax rates, price wars between tobacco companies may increase as a result of an increase in their market share. This, on the one hand, constrains the rise in prices for tobacco products with a corresponding negative impact on the receipt of the ad valorem component of the excise, VAT and income tax, and on the other hand – does not reduce the availability of these excisable goods, which impedes the achievement of health objectives. This problem is typical both for the countries of the European Union and for our state.

After the global financial and economic crisis of 2008-2009, most EU countries felt a sharp shortage of fiscal resources, which prompted higher excise rates. Such unidirectional national excise tax reforms have created prerequisites for revision of harmonised EU standards for excise duties on tobacco products. With the entry into force in 2012 Council Directive 2011/64/EU extended the scope of the use of a specific component of excise duty on cigarettes, which not only ensures stable budget revenue that do not depend on price levels and are also more effective in addressing health problems (provide the same level of load on cheap and expensive cigarettes, which contributes to the restriction of smoking). If, before 2012, the specific excise duty was not to be less than 5% and more than 55% of the total tax burden (VAT + ad valorem and specific excise taxes), then since 2014 these "framework" EU standards would be 7.5 and 76.5 % respectively. In addition, the Directive provides for an increase in the minimum level of excise duty on tobacco products. In particular, in 2014 the minimum excise duty on cigarettes in the EU has increased from EUR 64 to 90 per 1,000 pieces. This led to further increases in excise rates in countries that did not meet the revised standards.

In the context of the post-crisis strengthening of the fiscal role of excise tax on cigarettes, many EU countries, including Italy, Germany and France, experienced problems in collecting planned excise taxes because of the underpricing of cigarettes by individual tobacco companies, which had a negative impact on overall price increases. The presence of cheap cigarettes in the market, despite the increasing of excise for them, also did not contribute to reducing the popularity of tobacco smoking. At the same time, the reducing of the number of tobacco

products consumers, which had to quit their unhealthy habits due to increased prices for their favourite brands of these excisable goods, led to a reduction in tax revenue from tobacco products. In Germany, some consumers began to choose cheaper alternatives (first of all, finely chopped tobacco for cigarette rolling, which remained relatively cheap due to the relatively low excise rates), which intensified price wars with an increase of tobacco excise duty. The country implemented a reform that provided a gradual increase of the specific (from EUR 82.7 to EUR 98.2 per 1,000 pieces) and reduction of ad valorem (from 24.66 to 21.69%) excise duties for cigarettes in 2010-2015, as well as increase in the specific (from EUR 34.06 to EUR 48.49 per 1,000 pieces) and reduction of ad valorem tax component (from 18.57 to 14.76%) for the fine-cut tobacco for cigarette rolling²⁷. Prior to the significant reduction of the gap between the excise duty for these categories of excisable goods, the urgency of using an anti-dumping mechanism to secure cigarette excise tax revenues and VAT from cuts, significantly intensified.

Despite the relative freedom of the EU countries to choose the tax mechanisms, national practices to counteract the price depression on the tobacco market should be in line with the requirements of EU Council Directive 2011/64/EU. Not all countries succeeded in developing anti-dumping mechanisms with such compliance. The judgement of the European Court on the contradiction of a number of national tax innovations with the provisions of the Directive has led many countries to initiate their abolition. This limited the diversity of approaches to solving the problem of price wars between tobacco companies in the European Union. At the same time, the German anti-dumping mechanism for ensuring the stability of cigarette excise duties on the basis of establishing a minimum level of aggregate tax burden (excise + VAT), which complies with the provisions of the common European legislation, is now used and deserves special attention.

²⁷ Excise Duty Tables. Part III – Manufactured Tobacco. European Commission 2010.URL:http://www.adko.hu/01_files/adattar/tobacco_en.pdf; Excise Duty Tables. Part III – Manufactured Tobacco. European Commission 2012. URL: https://circabc.europa.eu/sd/a/f0f5445c-c154-4524-905f-0f8c15984494/Excise_Duty_Tables%20-%20III-Tobacco_July2012_REV1.pdf; Excise Duty Tables. Part III – Manufactured Tobacco. European Commission 2016.URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/excise_duties-part_iii_tobacco_en.pdf.

From 1 April 2010, in Germany, the excise tax (specific and ad valorem components) and VAT for the average weighted retail selling price of cigarettes have been calculated, which serves as a basis for comparison with the relevant figures for a specific maximum retail price. If the aggregate excise duty (excise duty + VAT) in a particular case is lower than the specified minimum threshold, the difference is payable as an additional excise duty²⁸. At the same time, by February 2016, a fixed amount of the minimum aggregate tax per unit of product was also established in the country. If it exceeded the same indicator for the weighted average retail price, the surcharge was calculated on the basis of this fixed amount²⁹. This dual regulation prevented cigarette tax revenue from decreasing even in the face of significant price fluctuation.

In 2011-2017, the fiscal mechanism for counteracting dumping on the cigarette market, which has been used by Germany, made it possible to accumulate excise revenues at the level of more than EUR 12 billion per year³⁰, despite the reduction of tobacco products consumption. Due to this, the fiscal and regulatory objectives of the policy for establishing a high tax burden on these excisable goods are achieved.

Ukraine is also interested in experience of ensuring the stability of tax revenue from cigarettes due to the restriction of Spain's dumping, which, on the eve of the adoption of EU Council Directive 2011/64/EU, has experienced the problem of balancing public finances, which was one of the largest in European

²⁸ According to the workshop "Law on Taxation of Tobacco Products. The requirements of European Union Council Directive 2011/64/EU. The proposed amendments to EU Council Directive 92/83/EU on the harmonisation of the structure of alcohol and alcoholic beverages excise duties. The state monopoly on the production and sale of alcohol in Germany ", organised on 10-12 July 2018, at the Ministry of Finance of Ukraine with the support of the German Society of International Cooperation (GIZ) within the framework of the project called "Support to the reform of public finance management". Experts – Friedrich Seewald and Dennis Nehring (Germany).

²⁹ Tobacco Tax Act (TabStG) TabStGAusfertigung date: 15.07.2009 (BGBl. I S. 1870). URL: <https://www.global-regulation.com/translation/germany/392902/tobacco-tax-act.html>; Excise Duty Tables. Part III – Manufactured Tobacco. European Commission 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf.

³⁰ Excise Duty Tables. Part III – Manufactured Tobacco (Tax receipts – Manufactured Tobacco). European Commission 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties_tobacco_en.pdf.

Union. The Spanish anti-dumping mechanism model, like the German analogue, involves paying a higher excise tax if the maximum retail price of cigarette sales is lower than a certain level. However, if in Germany this price threshold corresponds to the weighted average retail price, then in Spain it is set as a fixed amount. In case of failure to reach this level of prices, a higher level (second fixed amount) of the minimum excise tax is applied. In other words, the Spanish model, unlike German, does not provide for a phased increase in the additional excise tax as the maximum retail selling price of cigarettes decreases. In this case, the double minimum excise duty in Spain applies for both cigarettes and smoking tobacco: the excise for cigarettes must be at least EUR 131.5 per 1,000 pcs and increases to EUR 141 per 1,000 pcs if the maximum retail price is less than EUR 196 per 1,000 pcs; smoking tobacco excise duty should not be less than EUR 98.75 per kilo and is raised to EUR 102.75 per kilo if the retail sale price does not exceed EUR 165 per kilogram³¹. Note that the disadvantage of such an anti-dumping tool is that the sum of the price threshold and the double minimum excise tax should be adjusted in case of increase of excise tax rates.

Portugal, which also overcame significant fiscal problems, introduced a fairly high minimum excise duty for cigarettes. This threshold is set at 104% for the most popular cigarette price category (determined by law)³². Under such conditions, the achievement of fiscal goals is due to the tax "punishment" of cigarettes not only low but also the middle price segment, which negatively affects the development of the tobacco industry.

A number of European Union countries apply a minimum excise duty to stabilise cigarette tax revenues depending on the average weighted retail price of their sales.

Thus, in the EU countries, the practice of using fiscal mechanisms to counteract dumping in the tobacco market is widespread, which holds back the

³¹ Spain Corporate – Other taxes. PWC. URL: <http://taxsummaries.pwc.com/ID/Spain-Corporate-Other-taxes>.

³² Moita D. The Effects of Price Cap Regulation on Tobacco Market URL: https://sigarra.up.pt/flup/pt/pub.geral.show_file?pi_gdoc_id=133815.

increase of cigarette prices, preventing the achievement of fiscal and regulatory objectives for raising excise tax rates. In Ukraine, the increase of the excise duty for tobacco products is combined with the preservation of the legal sale of cigarettes, the maximum retail price of which is lower even than the amount of excise tax and VAT, provided for this price by legislation, which increases the urgency of introducing measures to restrict such dumping with signs of tax evasion taking into account European experience.

3. Analysis of the practice of collecting tobacco products excise tax in Ukraine

The effectiveness of the tax system of any country is determined by how successfully and purposefully it solves the problems associated with the formation of sufficient budget revenue in the form of tax revenue, regulation of economic processes as well as solving a variety of socio-economic problems. By its economic nature, the tax system has a fiscal and regulatory purpose, which manifests itself in influencing the pace and proportion of social and economic development of the state. The separate national tax system reflects specific conditions: the level of development of the economy, social sphere, foreign and domestic policy, local traditions, geographical position and many other factors. In this regard, the composition of the tax system, the structural ratios of individual taxes, the order of calculation, the forms of calculations, the organisation of the tax service may vary significantly.

From the point of view of the main provisions of financial theory, optimising the level of tax burden is one of the methods for solving the issues of effective state financial management and ensuring the regulation of the development parameters for certain sectors of the national economy. Taking into account the fact that taxation affects two parties of tax relations - the state and the taxpayer, the main principle of optimising the level of tax burden is precisely the balancing of interests of the state budget, business entities, citizens and the state.

A specific excise tax remains one of the most effective tools of tax regulation (in Ukraine - excise duty, with the adoption of the Tax Code - excise tax). The history of use of specific excise taxes in Ukraine dates back more than twenty five years, with some quite controversial periods of its application. However, today the most urgent issues include the determination of the optimal level of excise taxation and increasing the efficiency of its use both in limiting the consumption of goods that are harmful to human health and the impact on other qualitative and quantitative parameters of the market of excisable goods.

One of the main problems in the application of excise taxes throughout the period of modern history of Ukraine is the unsteadiness of tax legislation. Changes to the legislation regulating the application of specific excise duty in Ukraine were aimed both at improving the mechanism of excise tax application and served exclusively for fiscal goals – due to tax revenues, it was possible to generate additional financial resources directed at financing certain public goods. As a result, both fiscal and economic efficiency of the tax also changed, and in some years there was a decrease in real (taking into account the component of inflation) tax revenue.

However, from the point of view of achieving the strategic and tactical goals of state regulation of the national economy, the use of excise taxes remains insufficiently effective. Thus, the use of excise taxation in Ukraine does not allow to provide sufficiently effective impact on the volume of production and consumption of excisable goods; the structure of production, its profitability, as well as indirectly – on the quality of the products manufactured and the improvement of the consumer characteristics of the individual product³³.

Implementation of the excise policy aimed at increasing rates, in recent years, has led to an increase in the fiscal efficiency of the excise tax. Thus, in 2009, the ratio of excise tax revenue to nominal GDP increased from 1.3% to 2.4%. The specified indicator in 2010-2014 remained at the level of 2.5-2.9%, but in 2017 its

³³ The reformation the Tax System of Ukraine: Theory, Methodology, Practice: Monography / Yaroshenko F. O., Melnyk P. V., Myarovskiy A. I. etc.; under gen. edition of M. Ya. Azarov. Kyiv, 2011 Page 346.

value increased to 3.9%. The increase of the fiscal value of the excise tax was the result of unsystematic increasing of its rates, as well as the introduction of a number of new tools in the domestic tax administration practice. We emphasise that, in Ukraine, the share of excise tax in GDP is quite comparable with the corresponding indicators in EU countries; however, another structure of excise tax revenue is specific for our state.

In recent years, there has been a steady tendency for increase in the fiscal value of tobacco products excise tax, the share of which in 2017 was 32% of the total excise tax revenue (Figure 3.1) and 54% of the excise tax revenue from domestic goods. Since 2009, tobacco excise taxes have comprised almost 57% of all revenues from excise taxes at average and approximately 41% of domestic products excise taxes.

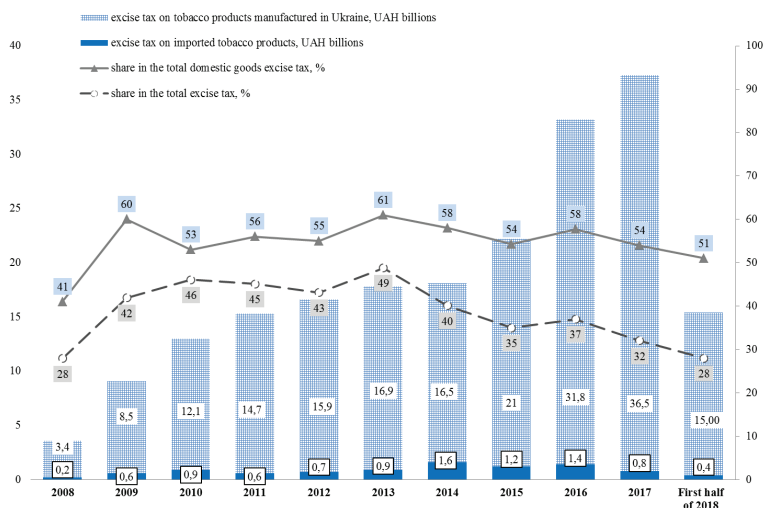


Figure 3.1. Trends of receipt of excise revenue on tobacco products and its share in total excise tax revenue in 2008-2018

Source: constructed by the authors according to the data of the State Statistics Service of Ukraine.

It should be noted that such fiscal indicators are due to the specific demand and supply of tobacco products in Ukraine. Tobacco products belong to large

taxpayers and the average excise tax paid by them is 5.0% of the consolidated budget tax revenues. Thus, top 100 largest payers, in 2017³⁴, included 4 companies that produce tobacco products, including PrJSC AT TK V.A.T.-Pryluky, PrJSC Philip Morris Ukraine, PJSC JT International Ukraine, JSC Imperial Tobacco Production Ukraine.

Accordingly, the tobacco products market in Ukraine is highly concentrated and oligopolistic, the index of Herfindahl-Hirschman in 2015-2018 ranged from 0.23 to 0.26. As at the middle of 2018, there were 16 tobacco manufacturers registered (Figure 3.2), but the largest shares belong to PrJSC Philip Morris Ukraine (28.3%), PrJSC AT TK V.A.T.-Pryluky» (25.9%) and PJSC JT International Ukraine (25.3%).

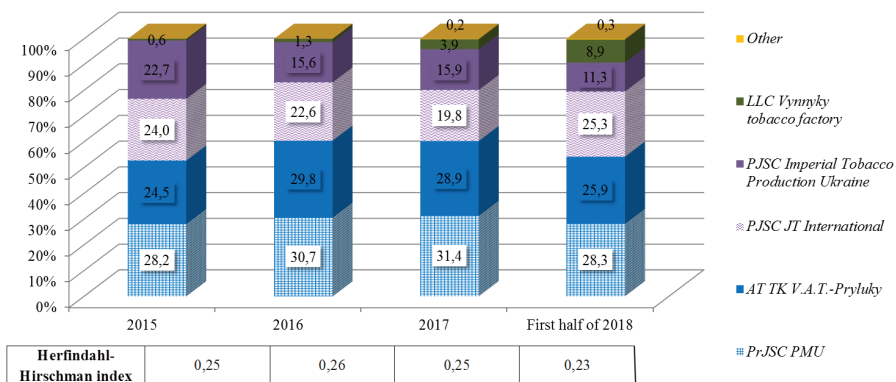


Figure 3.2. Herfindahl-Hirschman index 2015–2018

Source: calculated on the basis of data from SFS of Ukraine.

The license for retail trade was granted to more than 180 thousand retail outlets including specialised tobacco stores, supermarkets, hypermarkets, grocery stores, kiosks, snack bars, gas stations, hotels, restaurants and cafes, etc.

It should be noted that the dynamics of the tobacco market is significantly

³⁴ The Office identified the 100 largest payers. Large Taxpayers Office of the State Fiscal Service. 2018. URL: <http://officevp.sfs.gov.ua/media-ark/news-ark/324207.html>.

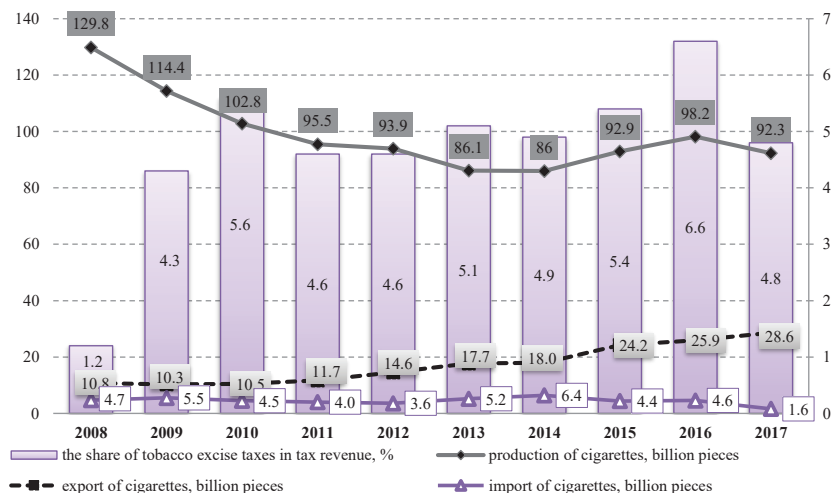
influenced by the excise policy, which until 2008 was quite liberal and led to an increase in the volume of tobacco products production. However, during the economic and financial crisis as a measure of "ambulance" of the budget, there was a significant increase in excise tax rates, which, in addition to unfavorable economic conditions, resulted in a decrease in official production of tobacco products to 94.0 billion pieces in 2012 and 86 billion pieces in 2014. In addition, this tendency can be explained by a reduction in the consumption of cigarettes on the background of a significant reduction in income levels among many social groups of Ukraine's population.

Data given in Figure 3.3 indicate that due to a significant increase in tobacco prices in 2009, on the background of decrease in overall tax revenue, the fiscal efficiency of the excise tax on tobacco products increased from 1.2% of the total tax revenue in 2008 to 4.3% in 2009, and in 2010–2017 this indicator ranged from 4.8% to 6.6% and amounted to an average of 5.2%. Since 2015, cigarette production in Ukraine has increased to 92.9 billion pieces, and in 2016 – to 98.2 billion pieces, which is mainly due to the increase of exports to 24.2 billion pieces in 2015 and 25.9 billion pieces in 2016.

According to the State Statistics Service of Ukraine, other indicators of the market changed over the same period: exports increased from 10.8 billion pieces in 2008 to almost 28.6 billion pieces in 2017, and imports – varied in the range of 3.6 and 6.4 billion pieces during 2008-2016 and decreased to 1.6 billion pieces in 2017.

It should be noted that such tendencies were reflected in the revenue of the excise tax on tobacco products during the period under consideration, which in absolute terms had a steadily positive trend. In addition to these factors, the increase of tax revenue was a consequence of both an increase in tax rates, changes in their structure, and the introduction of an advance payment of excise taxes. Tobacco manufacturers now pay a tax to the budget when purchasing tax stamps within fifteen business days after receiving them (often before the production starts). In this case, the amount of tax can be adjusted when changing the excise tax

rate (based on the rate applicable on the date of filing a tax declaration).



**Figure 3.3. Production, export, import of cigarettes
and the share of excise tax on tobacco products in the tax revenue
of the consolidated budget of Ukraine in 2006-2017**

Source: prepared by the authors according to the data of the State Statistics Service of Ukraine, the State Fiscal Service of Ukraine, the State Treasury Service of Ukraine.

Together with the change in the procedure for paying excise taxes in Ukraine, the emphasis was placed on the application of a mixed tax system for tobacco products. The advantage was given to a specific component, which, together with the achievement of purely fiscal objectives, made it possible to effectively influence the level of consumption of tobacco products. Simultaneous increase of the specific excise tax rate and ad valorem rate reduction in Ukraine corresponds to the modern trends of the European excise taxation of tobacco products, which are described in Section 2.

We will analyse the impact of the growth of the specific rate in Ukraine on the receipt of excise taxes. Thus, the highest rates of growth were in 2013 – 147%, in 2016 – 140%, in 2017 – 140%. Moreover, in 2014 – the beginning of the ATO

in the East of the country, rates have increased three-fold, and the aggregate growth rate has reached 140% (Table 3.1). This is evidence of the fact that the excise tax on tobacco products in Ukraine is used as one of the tools for solving the problem of public finances unbalance.

Table 3.1

Rates and speed of increase of excise tax revenue and the minimum excise tax liability for tobacco products in 2008-2018

Period of increase of tobacco products excise tax rate	Specific excise duty for filter cigarettes		Specific excise duty for non-filter cigarettes		Ad valorem excise duty for filter cigarettes, %	Minimum excise duty on filter cigarettes, UAH per 1,000 pieces.		Minimum excise duty on non-filter cigarettes, UAH per 1,000 pieces.	
	UAH per 1,000 pcs.	growth rate, %	UAH per 1,000 pcs.	growth rate, %		UAH per 1,000 pcs.	growth rate, %	UAH per 1,000 pcs.	growth rate, %
01.01.2013	162.6	147.0	72.7	147.5	12	217.6	118.0	95.4	135.0
01.01.2014	173.2	106.5	77.5	106.6	12	231.7	106.5	101.6	106.5
01.04.2014	216.5	125.0	96.9	125.0	12	289.6	125.0	127.0	125.0
01.08.2014	227.3	105.0	101.7	105.0	12	304.1	105.0	133.4	105.0
01.01.2015	227.3	100.0	227.3	223.5	12	304.1	100.0	304.1	228.0
01.01.2016	318.3	140.0	318.3	140.0	12	425.8	140.0	425.8	140.0
01.01.2017	445.6	140.0	445.6	140.0	12	596.1	140.0	596.1	140.0
01.01.2018	577.98	129.7	577.98	129.7	12	773.2	129.7	773.2	129.7
01.01.2019*	693.58	120.0	693.58	120.0	12	927.84	120.0	927.84	120.0
01.01.2020*	832.29	120.0	832.29	120.0	12	1,113.4	120.0	1,113.4	120.0
01.01.2021*	998.75	120.0	998.75	120.0	12	1,336.08	120.0	1,336.08	120.0
01.01.2022*	1,198.5	120.0	1,198.5	120.0	12	1,603.3	120.0	1,603.3	120.0
01.01.2023*	1,438.2	120.0	1,438.2	120.0	12	1,923.96	120.0	1,923.96	120.0
01.01.2024*	1,725.84	120.0	1,725.84	120.0	12	2,308.75	120.0	2,308.75	120.0
01.01.2025*	2,071.0	120.0	2,071.0	120.0	12	2,770.5	120.0	2,770.5	120.0

*planned rates according to the Law of Ukraine on Amendments to the Tax Code of Ukraine and certain legislative acts of Ukraine on ensuring the balance of budget revenue in 2018: Law of Ukraine dated 7 December 2017, No. 2245-VIII.

Source: compiled by the authors on the basis of legislative acts of Ukraine.

At the same time, the increase of revenue from excise tax on tobacco products during these periods was not proportional to the rate increase. So in 2013 they were 108%, in 2014 – 101%, in 2015 – 123%, in 2016 – 149%, in 2017 – 120%. Only in 2016 the rates of increase of revenue exceeded the rate of increase of the excise tax rate by 9.4% (Figure 3.4). Such trends can be explained, in particular, by the inconsistent excise policy characterised by sudden decision-making on raising rates due to lack of funds in the budget, rather than a well thought out and forward-looking strategy for reducing tobacco consumption in accordance with the WHO Framework Convention on Tobacco Control (hereinafter referred to as WHO FCTC). This situation created significant barriers

for doing business in the tobacco market.

It should also be noted that until 2015 the system of excise taxation for tobacco products in Ukraine was based on the application of various tax rates for filter and non-filter cigarettes (Table 3.1). Such a mechanism for the excise taxation of tobacco products, firstly, contradicted to the requirements of the EU Council Directive 2011/64 of 21 June 2011, and, secondly, gave rise to a negative tendency to raise the sales of non-filter cigarettes, the rate of excise duty for which was two times lower than that the excise duty for filter cigarettes. This created price competitive advantages for more harmful products. Thus, the sale of non-filter cigarettes increased from 7.5 billion in 2013 to 12.6 billion in 2014, meaning that some consumers prefer to use low-cost segment cigarettes. With the introduction of tax rates and the amount of the minimum tax liability to a single level in 2015, this trend has stopped, cigarette production without filter has decreased from 12.6 billion units in 2014 to 5.8 in 2015 and 2.3 in 2016. It also had a positive impact on the excise tax revenue, which in 2015 increased by 22.8%, and in 2016 – by 49.4% compared to the previous year.

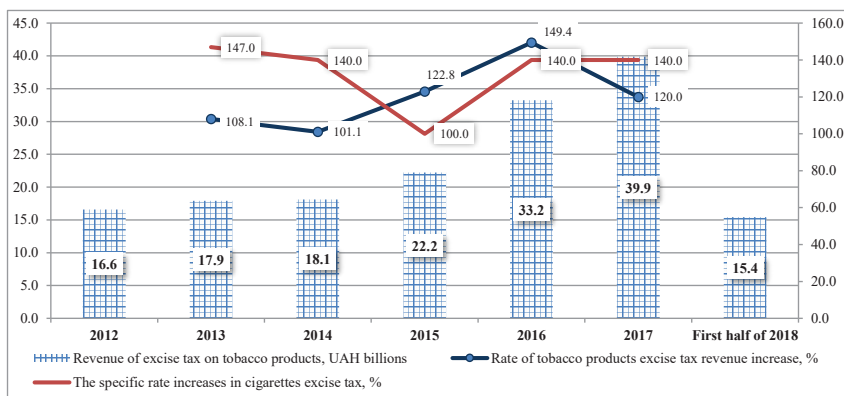


Figure 3.4. The dynamics and rates of growth of tobacco products tax revenue and rates during 2012-2018

Source: prepared as per data of the State Treasury Service of Ukraine and Tax Code of Ukraine.

The Law of Ukraine dated 7 December 2017, No. 2245-VIII³⁵ provides for an increase in excise tax rates for tobacco products in 2018, taking into account preliminary indexing by a total of 29.7%, and in the future by 2025 – by 20% annually until the EU minimum level is reached. This is an extremely important step towards solving one of the main problems of tobacco products excise taxation – the unpredictability of the excise tax rates increase.

Note that the increase in excise taxes for tobacco products in the countries that got EU membership was carried out within 12–15 years. In Ukraine, an accelerated timetable for raising excise tax rates for tobacco products may increase the illegal turnover of tobacco products. Taking into account the European experience and the current financial and economic situation in Ukraine, in order to achieve the appropriate level of excise tax, the transitional period should provide for more steady increase in rates and be sufficient to secure the rights of taxpayers, avoid negative economic phenomena and reduce budget revenue.

Despite the positive effect of the stability of the schedule for raising excise tax rates for tobacco products, the practice of reforming the excise taxation of the European Union states means that such measures may also have negative consequences for Ukrainian budget in the future, which should include forestalling.

Analysing the quarterly revenue from the excise tax for tobacco products (Figure 3.5), it can be seen that in 2012-2014 they were characterised by high volatility and different trends of fluctuations during the year.

If in the first quarter of 2012, after raising the rates, revenue grew, then in the first quarter of 2013, the situation turned out to be quite the opposite, which possibly caused by the abolition of the mechanism for paying the excise tax after filing the declaration. Since 2013, advance payment of tax by tobacco manufacturers has been introduced after the receipt of tax stamps with extra payment (if necessary) as of the day of filing tax declaration³⁶. However, while

³⁵ On Amendments to the Tax Code of Ukraine and certain legislative acts of Ukraine on ensuring the balance of budget revenue in 2018: Law of Ukraine dated 7 December 2017, No. 2245-VIII. URL: <http://zakon.rada.gov.ua/go/2245-19>.

³⁶ The Tax Code of Ukraine dated 02.12.2010 No. 2755-VI URL:

analysing such transformation, we note that it does not comply with the general practice and is associated with the diversion of working capital of tobacco companies. Due to this, the excise duty payment period has been increased to five days from 2017, and from 2018 – up to fifteen days after the receipt of the tax stamps.

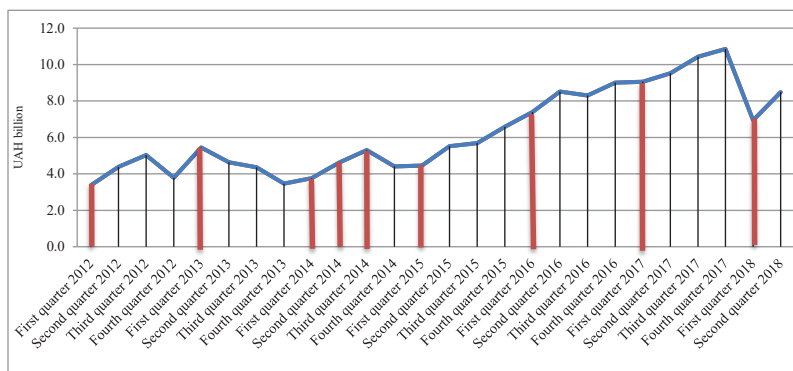


Figure 3.5. Dynamics of quarterly revenue of the excise tax on tobacco products in Ukraine during 2012-2018³⁷

Source: prepared as per data of the State Treasury Service of Ukraine.

As noted before, in 2014, when political and economic instability appeared, rates were raised several times, so this period is not indicative for revealing trends in the payment of excise taxes during the year. Annual trends for 2015-2017 are similar and characterised by an increase in excise tax revenues in the third and fourth quarters, which is the evidence of accumulation of tobacco product stocks by their manufacturers before the raising of the rate. Taking into account the fact that tobacco products are products with fast turnover and low price elasticity of demand, being almost independent from seasonality, the dynamics of the tax base should be similar to the dynamics of tax revenue, and any deviations from the average monthly indicators can indicate the optimisation measures for excise tax payment. In order to confirm or refute this hypothesis, it is expedient to analyse the

<http://zakon2.rada.gov.ua/laws/show/2755-17/paran5593#n5593>.

³⁷ The red line shows the periods of the rate increase.

monthly volume of acquired tax stamps in comparison with physical volumes of sales of tobacco products and the monthly excise tax revenue compared to sales in valuable terms³⁸.

Analysing data for 2015 (Figure 3.6), one can see that January's revenue is significantly lower than the average monthly, which may indicate that at this time, manufacturers sell products that were taxed in previous year. From February to May, revenue trends coincide with sales volumes, and from June to August, tax revenue increases while sales volumes decrease. Starting in September, revenue exceeds the average monthly level, and with the decrease of sales volumes it increases, which indicates the beginning of accumulation of tobacco products before raising rates from 1 January 2016.

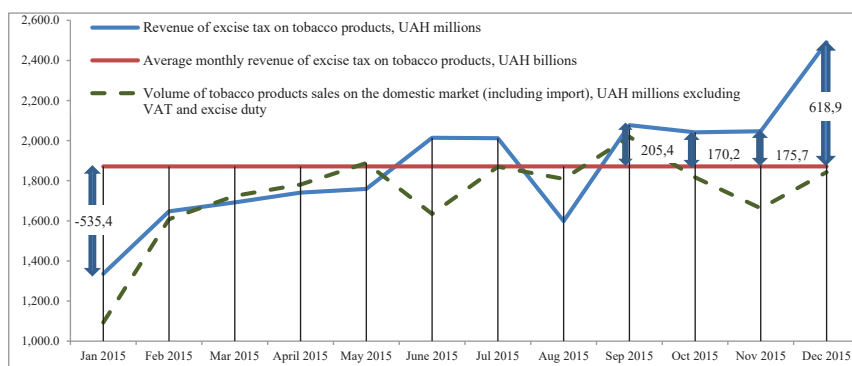


Figure 3.6. The trends of the monthly revenue of the tobacco products excise tax and the volume of their sales in 2015³⁹

Source: calculated by the authors according to the State Treasury Service of Ukraine and the State Statistics Service of Ukraine.

The volume of acquiring tax stamps (Figure 3.7) since June is higher than the average monthly indicator (except for August and September), and from October to December the percentage of excess is 9.1, 16.3 and 51.0%, respectively, which confirms previous conclusions.

³⁸ The sales volume of tobacco products by manufacturers and importers in the domestic market excluding VAT and excise tax.

³⁹ Hereinafter, volumes of sales of tobacco products on the domestic market are indicated, except for imports.

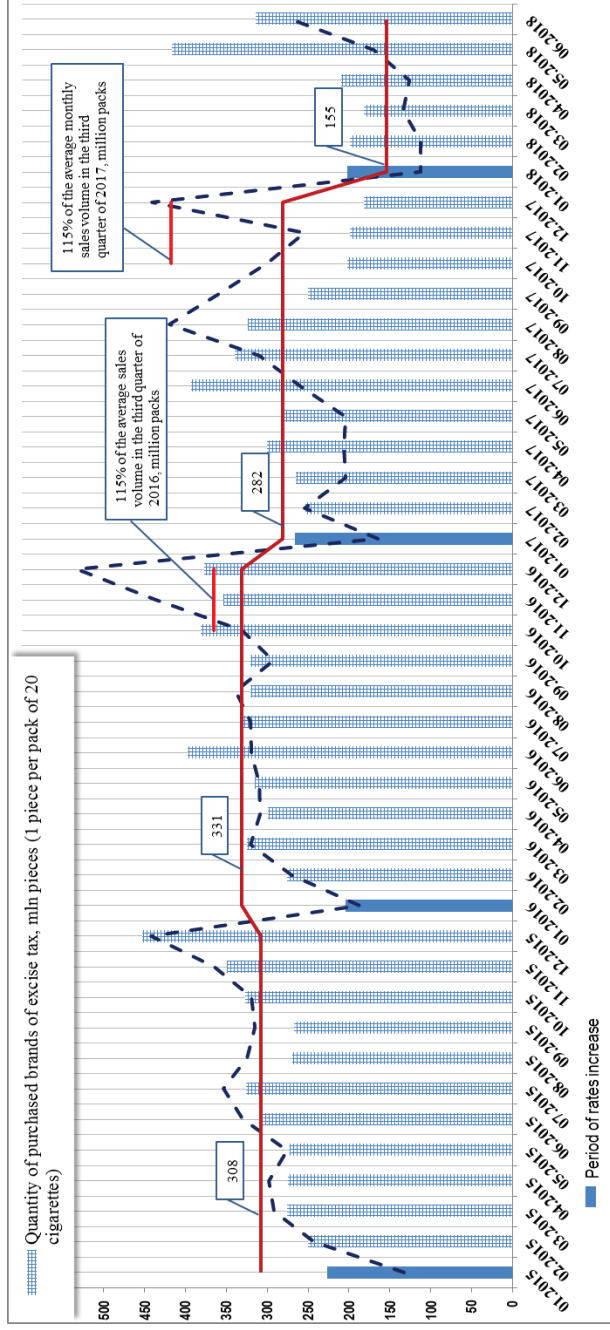


Figure 3.7. The trend of sales volumes of tobacco products and the number of purchased stamps during 2015-2018

Source: Calculated by the authors according to the State Fiscal Service of Ukraine data.

The situation with monthly revenue in 2016 and 2017 is similar to the situation in 2015: significantly lower in January than the average monthly value and much higher in the third and fourth quarters. In spite of this, the sales volume has a constantly growing trend, with a slight decrease in November. In the fourth quarter of 2016, the volume of the acquisition of stamps exceeded the average monthly volumes of sales of cigarettes in the third quarter by 11–20% (Figure 3.8).

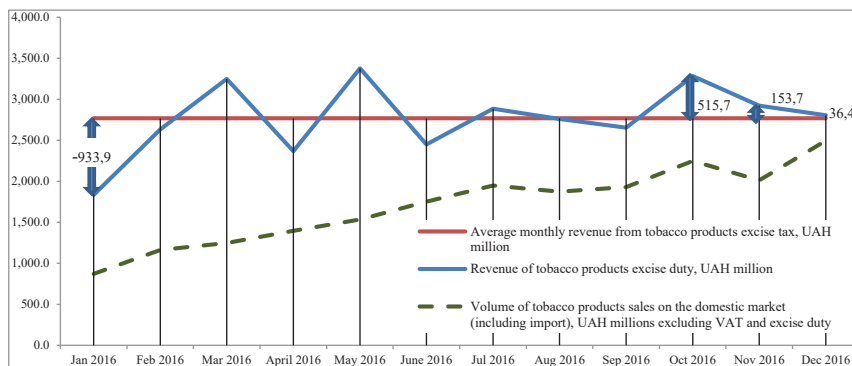


Figure 3.8. The trend of the monthly revenue of the tobacco products excise tax and the volume of their sales in 2016

Source: calculated by the authors according to the State Treasury Service of Ukraine and the State Statistics Service of Ukraine.

In response to such challenges, since 2017, forestalling preventing measures have been introduced in the form of restrictions on the purchase of tax stamps in the fourth quarter (Figure 3.9). Namely, the volume of sales of stamps to the manufacturer or importer of tobacco products in a month should not exceed 115% of the average monthly sales volume in the customs territory of Ukraine for the three previous calendar months. According to European practice, such a measure can be attributed to the quota for the purchase of tax stamps (*cap on tax stamps*).

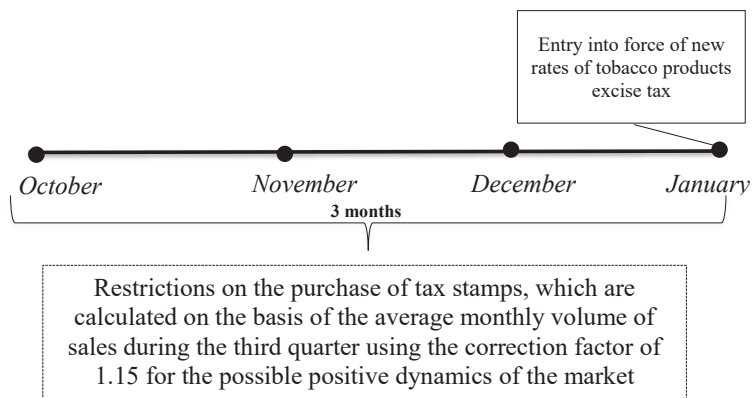


Figure 3.9. Scheme of anti-forestalling measures in Ukraine (*cap on tax stamps*)

Source: compiled by the authors on the basis of Tax Code of Ukraine.

However, according to Figure 3.10, this provision did not ensure the achievement of anti-forestalling goals, since from August to December 2017, there were fundamentally opposite trends in sales volumes and tax revenue, indicating the beginning of accumulation of tobacco product stocks starting from not the fourth, but rather from the third quarter. So, in the third quarter, the volume of acquiring tax stamps significantly exceeded the average monthly volume of sales of the first and second quarters, in particular, in July – by 57.4%, in August – by 49.9%, in September – by 15.7%.

As noted above, taxpayers begin to accumulate cigarettes for the purpose of forestalling since the third quarter (i.e. within six months), in this regard, the loss of tax revenue from this phenomenon can be determined by comparing the sales volume in these quarters and the revenue of the average sales volume multiplied by 6 and multiplied by the difference between the minimum tax liability of the current excise tax and next year by the following formula:

$$Tax\ gap_f = (SV_{III\ IV} - ASV_{I\ II} \cdot 6) \cdot \Delta \min ET$$

$$(\Delta \min ET = \min ET_{t+1} - \min ET_t) \quad (2.1)$$

where $Taxgap_f$ – the amount of loss of tax revenue of excise tax as a result of the use of forestalling measures, thousand UAH;

$SV_{III\ IV}$ (*Sales Volume*) – the volume of sales of tobacco products in the III and IV quarters of the current year, thousand pieces;

ASV_{III} (*Average Sales Volume*) – the average sales volume during the first and second quarters of the current year, thousand pieces;

$\min ET_t$, $\min ET_{t+1}$ (*Minimum Excise Tax*) – the minimum tax liability for excise tax in the current and next year, UAH per 1,000 pieces.

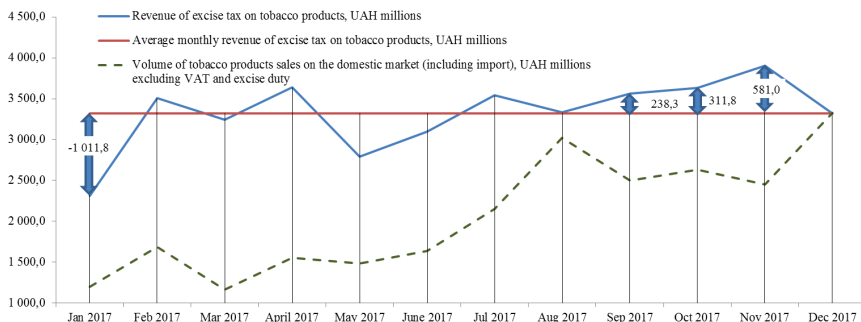


Figure 3.10. The dynamics of the monthly revenue of the tobacco products excise tax and the volume of their sales in 2017

Source: calculated by the authors according to the State Treasury Service of Ukraine and the State Statistics Service of Ukraine.

So, the current anti-forestalling mechanism did not achieve the goal of counteracting the accumulation of tobacco products before raising excise tax rates. However, according to the European anti-forestalling control experience, not all countries have introduced an effective system of measures on the first attempt. It is rather difficult to design a mechanism that would simultaneously provide stable tax revenue throughout the year and take into account changes in market conditions, while not disrupting the functioning of the tobacco market.

According to the calculations using the described methodology, the amount of tax revenue lost as a result of forestalling during 2015–2017 amounted to UAH 66.7 – 139.9 million (Figure 3.11).

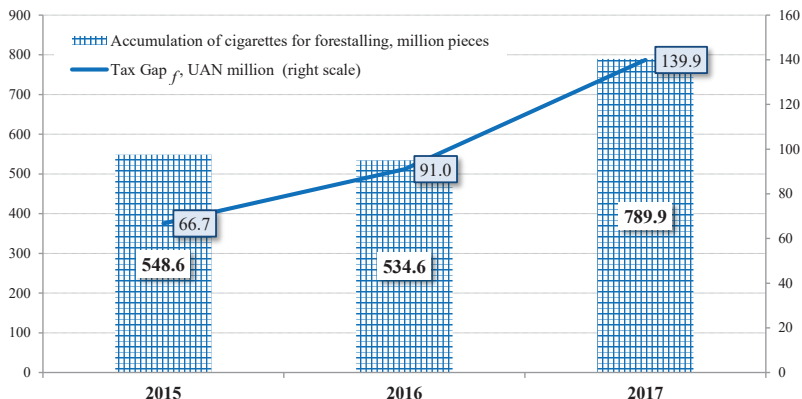


Figure 3.11. The dynamics of the tax breach from the excise tax on tobacco products as a result of the forestalling sale during 2015–2017

Source: calculated by the authors according to the State Treasury Service of Ukraine and the State Statistics Service of Ukraine.

On the basis of the analysis of the effectiveness of anti-forestalling regulation in Ukraine and the best European practices, we believe that it is necessary to change the domestic methodology for calculating quotas for the sale of tax stamps. They should be used in the third and fourth quarters and should be established by calculating the maximum possible monthly sales volume of tax stamps to the manufacturer or importer of tobacco products based on the average monthly sales volume of the previous year, and not on the basis of the three preceding calendar months of the current year (Figure 3.12). Moreover, the correction coefficient for the possible growth of sales volume should be established on the basis of the trend in the tobacco market. Since the 2015-2017 period was characterised by a declining trend (the average annual rate of decline was 97.4%), we believe that this ratio should be set at 105%.

As an additional anti-forestalling measure, we propose to set the final date for the sale of tobacco products at wholesale and retail trade with tax stamps purchased the previous year (*sell-by date at retail*), which should be 3 months. Such a term is due to the need to create conditions for the free movement of goods at all levels of the supply chain. We believe that this will ensure an effective counteraction to the forestalling in the III and IV quarters, equalise the revenues of the excise tax on tobacco products during the year and will enable to receive the appropriate volumes of tax revenues at higher rates, will not have a significant effect on the market of tobacco products. At the same time, it is expedient to increase the deadlines for transferring the excise tax to the budget to reduce the distraction of working capital of taxpayers.

New system of anti-forestalling control: quotas for the purchase of tax stamps + the final date for the sale of tobacco products in the wholesale and retail trade

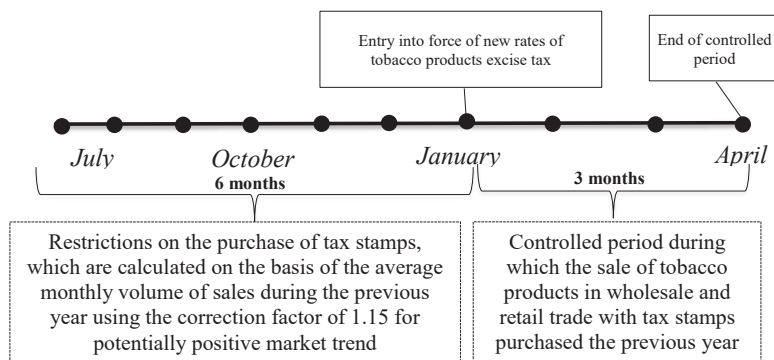


Figure 3.12. The proposed anti-forestalling control system in Ukraine

Source: developed by authors.

Another possible anti-forestalling measure may be the change in the mechanism of payment of excise tax on tobacco products to the one that provides the conversion to the budget of taxes payable by manufacturers and importers of tobacco products (excise taxpayers) after the fact of selling products within the time set by the Tax Code of Ukraine for a monthly tax period. Such a mechanism

would make the use of forestalling measures by the manufacturers unprofitable, and the budget will transfer taxes at the rate that is valid at the time of products sale.

It should be noted that forestalling activities performed by taxpayers negatively affect not only tax revenue, but significantly reduces the effectiveness of the tobacco control policy (MPOWER). Taxation is the most common and the only tool for monitoring tobacco use. Economic theory points out that an increase in taxes on tobacco products leads to an increase in the direct costs of their consumers and, thus, leads to a decrease in their consumption. However, raising excise taxes is not always an effective means of limiting the consumption of products that cause sustained dependence. As noted above, research on the tobacco market suggests that demand for these products is inelastic at the price among adult population that has become resistant to tobacco dependence. In this case, the replacement effect appears, the consumers select the cheaper cigarettes, which, as a rule, are more harmful to health.

Today, there is a significant difference between consumption and sales of tobacco products in the retail chain due to various factors, including illegal trade. Counterfeit products that come from uncontrolled territory of Ukraine, export of cigarettes to the EU countries, as well as cases of counterfeit non-filter cigarettes, remain current issues in this area. According to business representatives, by 2015, non-filter cigarettes counterfeiting was extremely rare, but a sharp increase in excise tax rates for this type of cigarettes triggered the activation of the shadow business⁴⁰.

The sharp increase in excise tax rates in Ukraine can lead to negative consequences and an increase of cigarettes illegal traffic. Countries that already have similar experience are the new EU members who have recently overcome the stage of adaptation of tax legislation to the requirements of EU directives. A number of countries implemented sharp and economically unjustified increase of

⁴⁰ The tobacco industry remains a source of replenishment of the treasury. Bulletin. Ofitsiino pro podatky. 2016. URL: <http://www.visnuk.com.ua/uk/publication/19-tyutyunova-galuz-zalishayetsya-dzherelom-popovnennya-skarbnitsi>.

excise tax rates on tobacco products, which led to an increase in consumption of illegal products⁴¹.

So, the direct consequence of raising the rates of excise tax on tobacco products in Ukraine is an increase in their prices and a decrease in their availability for the average consumer. Changing rates also affect other market parameters, in particular, the structure of the offer provokes an increase of the market shadow segment and the extension of forestalling activities. At the same time, the final result of the strengthening of the excise fiscal role is mostly dependent on the taxation mechanism and the used control system for the circulation of tobacco products. However, in determining the ways of further reforming the excise tax in Ukraine, it is appropriate to take into account not only the national peculiarities of the excise tax but also the best practices of the EU countries. Especially those who have faced the problem of extending the illegal market when introducing a long-term schedule of raising excise tax rates.

4. Ways of reforming the excise tax on tobacco products in Ukraine, taking into account the requirements of EU directives and European experience

Ways of reforming the excise taxation of tobacco products in Ukraine, taking into account the requirements of the EU Directives and European experience. The Systemic Crisis of 2008–2009 has intensified scientific research in determining the role of the state in the regulation of socio-economic processes, justification of the areas of optimisation of control and supervision activity in certain product markets, among which tobacco occupies a special place. The need for solving these, often conflicting, difficult tasks requires states governments to formulate and implement a sound fiscal policy as an important component of the overall socio-economic policy of the state focused on the formation of a tax system, the features of which are the use of incentives for the accumulation and rational use of the national

⁴¹ Filling the budget by improving excise policy in Ukraine. Audit company HLB Ukraine. 2014. URL: www.hlb.com.ua.

wealth of the country for ensuring socio-economic progress of society⁴². Therefore, further reformation of the excise tax in Ukraine should be directed to eliminating disproportions in the use of fiscal opportunities and the regulatory potential of excise taxation, as well as the adaptation of national legislation to the EU requirements. The urgent need is to review the approaches to the excise policy of Ukraine.

When deciding on a significant increase in excise tax rates, it is required to understand what negative consequences this can lead to and how difficult it will be to overcome those effects, when the reverse reduction of excise tax burden will be extremely complicated from political point of view. It is quite easy to provoke the new extension of the shadowing of charging and paying excise taxes on tobacco products through radical tax initiatives, but the reverse movement has many obstacles. The amount of the shadow economy in Ukraine is much larger than in other post-socialist countries of the European Union. The efforts of our state, aimed at shadowing economic relations, have not yet led to significant positive changes.

In 2018, the rules of the Tax Code of Ukraine entered into force, according to which in 2019-2025 the specific excise tax rate and the minimum excise tax liability for cigarettes will be increased by 20% annually⁴³ to the level of UAH 2 071.01 (EUR 67.7)) and UAH 2 770.50 (EUR 90.5) per 1,000 pieces accordingly. At the same time excise tax rates for other tobacco products, tobacco raw materials and waste will be increased to UAH 2,601.91 or EUR 85 per kilogram in 2025. This tax transformation ensures the approximation of Ukraine's excise tax to harmonised EU standards. In countries with low cigarette prices (including Ukraine), the focus on raising the specific excise tax rate makes it possible to more quickly reach the minimum level of excise duty which is valid in the European Union⁴⁴. Therefore, our state's strategy for strengthening the fiscal role of excise

⁴²Maiburov I. A. Theory and history of taxation. Moscow: Unity-Dana, 2007. Page 42.

⁴³ In 2016, these indicators have already increased by 40%, in 2017 – by 40%, in 2018 – by 30%.

⁴⁴ Tax harmonisation in Ukraine under the terms of the Association Agreement between Ukraine and the EU: monograph / ed. A.M. Sokolovska Kyiv, 2017. Page 348.

tax on cigarettes by increasing the specific excise duty needs to be evaluated positively. In addition, in conditions of dynamic growth of tax rates and low purchasing ability of the population, cigarette prices are likely to grow more slowly as compared to the excise burden. Therefore, the minimum indicator (60%), referred to in paragraph 2 of Art. 100 of EU Council Directive 2011/64/EU will be further exceeded in Ukraine.

At the same time, the expediency of the further increase in the specific rate of excise tax and the minimum excise tax liability on cigarettes, tax rates for excise duties for other tobacco products, tobacco raw materials and waste by 20% annually is controversial in the period between 2019-2025. By developing measures to raise excise duty rates, Ukraine is able to do so in such a way as to enable enterprises to adapt to the effects of increasing excise rates and to reduce the possible negative impact on employment in the spheres that produce excise goods. If these effects are not taken into account, then these are the mistakes of the internal excise policy and not the result of signing the Association Agreement⁴⁵.

In order to implement the Association Agreement with the EU, it is necessary to amend the Tax Code of Ukraine regarding the structure of excisable goods – the separation of "harmonised" tobacco products, setting their definitions, which was to happen until 1 November 2016 (as discussed in Section 1).

We also believe that, in case of strengthening the fiscal role of excise tax on tobacco products in the context of the implementation of the European integration strategy of Ukraine, it is necessary to take into account not only the relevant harmonised standards of the European Union but also the current trends of excise tax evolution in the EU. Due to this, our country is highly interested in the analysis of the level and dynamics of excise tax rates for cigarettes in the United Europe (in the context of EU top 15 states and the less developed new EU countries) in 2010-2018 period, when the development of public finances is mostly subordinate to the dominant of fiscal consolidation (Table 4.1).

⁴⁵Sokolovska A. M., PetrakovYa. V. Harmonisation of the administration of excise tax in Ukraine in the process of implementing the Association Agreement. *Business Inform.* 2017. No. 11. Page 390.

Rates of cigarette excise tax in the EU countries in 2010-2018

	Countries	2010		2012		2014		2016		2018	
		Specific EUR per 1,000 pieces	Ad valorem, %	Specific, EUR per 1,000 pieces	Ad valorem, %	Specific, EUR per 1,000 pieces	Ad valorem, %	Specific, EUR per 1,000 pieces	Ad valorem, %	Specific, EUR per 1,000 pieces	Ad valorem, %
1	Austria	26,69	43.00	35.00	42.00	40.00	41.00	50.00	39.00	58.00	37.50
2	Belgium	15,93	52.41	16,25	52.54	23.59	50.41	39.52	45.84	64.60	40.04
3	United Kingdom	130,68	24.00	180,26	16.50	220.61	16.50	266.62	16.50	245.68	16.50
4	Greece	13.71	58.43	20.00	52.45	20.37	20.00	82.50	20.00	82.50	26.00
5	Denmark	84.59	20.80	90.70	1.00	138.55	1.00	158.50	1.00	158.90	1.00
6	Ireland	183.42	18.25	233.11	9.04	241.83	8.72	271.96	9.20	309.04	9.04
7	Spain	10.20	57.00	19.00	55.00	24.10	51.00	24.10	51.00	24.70	51.00
8	Italy	6.95	54.74	8.92	54.35	13.10	52.41	17.88	51.03	19.28	51.00
9	Luxembourg	16.89	47.84	17.25	48.09	17.75	48.14	18.39	46.65	18.89	46.65
10	Netherlands	92.17	20.52	138.23	7.57	173.97	0.95	179.07	0.83	173.10	5.00
11	Germany	82.70	24.66	92.60	21.87	96.30	21.74	98.20	21.69	98.20	21.69
12	Portugal	67.58	23.00	78.37	20.00	87.33	17.00	90.85	17.00	94.89	15.00
13	Finland	17.50	52.00	22.50	52.00	28.00	52.00	41.50	52.00	58.00	52.00
14	France	16.88	57.97	27.58	54.57	48.75	49.70	48.75	49.70	59.90	50.80
15	Sweden	30.42	39.20	152.85	1.00	163.33	1.00	159.99	1.00	160.32	1.00
EU-15		53.08	39.59	76.53	32.53	94.65	28.77	103.19	28.16	108.4	28.28
16	Bulgaria	51.64	23.00	51.64	23.00	51.64	23.00	35.79	38.00	55.73	25.00
17	Estonia	33.55	33.00	42.18	33.00	46.50	34.00	58.00	30.00	69.50	30.00
18	Cyprus	20.50	44.50	40.00	40.00	55.00	34.00	55.00	34.00	55.00	34.00
19	Latvia	31.77	34.50	35.25	34.00	51.80	25.00	56.20	25.00	74.60	20.00
20	Lithuania	38.23	25.00	40.55	25.00	45.47	25.00	50.68	25.00	59.00	25.00
21	Malta	22.00	50.00	77.00	25.00	82.50	25.00	100.00	25.00	107.00	23.40
22	Poland	34.59	31.41	39.02	31.41	48.87	31.41	48.70	31.41	47.94	31.41
23	Romania	48.50	22.00	53.18	20.00	60.40	19.00	74.57	14.00	73.61	14.00
24	Slovakia	52.44	23.00	58.00	23.00	59.50	23.00	61.00	23.00	61.00	23.00
25	Slovenia	18.97	44.03	34.15	39.06	67.92	23.01	68.83	21.18	71.32	22.61
26	Hungary	34.60	28.30	40.41	31.00	42.22	31.00	50.19	25.00	52.02	25.00
27	Croatia	n/a	n/a	n/a	n/a	27.57	37.00	30.10	38.00	41.35	34.00
28	Czech Republic	42.09	28.00	45.02	28.00	46.40	27.00	51.15	27.00	56.16	27.00
EU-13		35.74	32.23	46.37	29.37	52.75	27.49	56.82	27.43	63.4	25.72
EU-28		45.38	36.32	62.57	31.13	75.2	28.18	81.67	27.82	87.51	27.09

Source: Excise Duty Tables, Part III – Manufactured Tobacco, European Commission, 2012 URL: https://circabc.europa.eu/sd/a/105445c-c154-4524-905f-08e15984494/Excise_Duty_Tables%20-%20III-Tobacco_July2012_REV1.pdf; Excise Duty Tables, Part III – Manufactured Tobacco, European Commission, 2014, URL: https://circabc.europa.eu/sd/a/7dee41d-834-420e-96ac-e01020693195/III-Tobacco_July2014%20final.pdf; Excise Duty Tables, Part III – Manufactured Tobacco, European Commission, 2016, URL: [https://ec.europa.eu/taxation_customs/sites/taxation_customs/sites/taxation/files/docs/body/excise_duties-part_iii_tobacco_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/excise_duties-part_iii_tobacco_en.pdf); Excise Duty Tables, Part III – Manufactured Tobacco, European Commission, 2018, URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/Excise_duties_tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf.

In the period from 2010-2018, all countries of the European Union without exception increased the specific excise tax rate. In this case, the relevant average rate in the EU-28 increased 1.93 times – up to EUR 87.51 per 1,000 cigarettes, in the EU-15 – 2.04 times up to EUR 108.4 per 1,000 cigarettes, in new EU countries – 1.77 times up to EUR 63.40 per 1,000 cigarettes. The average rates between the last two groups of countries in 2018 were distinctive by a factor of 1.71 since less developed countries have more limited opportunities to increase fiscal role of excise duties compared to more advanced ones. Ukraine is far behind even the least developed post-socialist countries of the EU by the level of economic development. Therefore, indicators of the EU countries should not be a benchmark for a domestic specific rate. Ukraine should take actions to bring the national specific excise tax rate closer (in 2018 it is EUR 18.88 per 1,000 cigarettes⁴⁶) to European minimum excise standards, but gradually, taking into account national economic and institutional realities.

Most EU countries (24 out of 28) decreased the ad valorem excise duty rate. As a result of the change in the structure of cigarettes excise tax in the European Union, there was a marked decrease in the corresponding average rates: EU-28 – from 36.32 to 27.09%, EU-15 – from 39.59 to 28.28%, new EU countries – from 32.23 to 25.72%. Moreover, Sweden and Denmark set an ad valorem excise duty rate of 1% (did not opt out of it entirely because common European legislation regulates mixed system of cigarettes excise taxes).

The ad valorem rate remains high today in EU-15 with traditions of a significant share of the ad valorem component in the structure of excise taxation and high incomes of population. However, many of them have decreased the ad valorem rate (Austria and Belgium recently). Latvia and Romania – the least developed countries in the EU – decreased this rate to 20 and 14% respectively in 2014-2018. Bulgaria, after an ineffective increase of the ad valorem rate from 23% to 38%, conducted a reverse reform of cigarettes excise taxation reducing the ad valorem to 25%. Similar reverse transformations have also been implemented in

⁴⁶ As per exchange rate of the National Bank of Ukraine as of 10 July 2018, which is 1 : 30.6.

Croatia.

Such reforms of the structure of cigarettes excise taxation in the EU are unidirectional with the establishment of a low ad valorem rate in Ukraine (12% since 2013, which is lower than in Denmark, Ireland, the Netherlands and Sweden) and an increase in the domestic excise duty for these tobacco products due to the specific excise duty.

Despite the above general trends of increasing the fiscal role of the European excise taxation for cigarettes, a significant variation of the level and structure of rates remains in the territory of the United Europe. In 2018, the specific rate of excise duty per 1,000 cigarettes was from EUR 18.89 in Luxembourg to EUR 309.04 in Ireland, ad valorem – from 1% in the above mentioned Denmark and Sweden to 52% in Finland. In the EU post-socialist countries, such a range of discrepancies was lower than in the countries of the Old Europe, but significant too: the specific rate for 1,000 cigarettes – from EUR 41.35 in Croatia to EUR 74.60 in Latvia; ad valorem – from 14% in Romania to 34% in Croatia. Obviously, these differences make it impossible to significantly narrow the European standard for the ratio of specific and ad valorem components of excise duty for cigarettes⁴⁷, providing countries (incl. Ukraine) wide a "field for maneuvers" in the development of traditional national models of excise taxation in the long-term perspective, taking into account the requirement of a common EU legislation on minimum excise duty of EUR 90 per 1,000 cigarettes.

As the increase of the specified minimum excise duty for cigarettes from EUR 64 to EUR 90 occurred in 2014, the relevant provision became part of the common European legislation in 2011 with the adoption of EU Council Directive 2011/64/EU (with exceptions for Bulgaria, Greece, Estonia, Latvia), Lithuania, Poland, Romania and Hungary, which were able to reach the threshold of EUR 90 by the beginning of 2018)⁴⁸, it is important to analyse the dynamics of this

⁴⁷ According to Art. 8(4) of EU Council Directive 2011/64/EU the specific excise duty should not be less than 7.5% and more than 76.5% of the total tax burden (VAT + ad valorem + specific excise tax).

⁴⁸ On the structure and rates of excise taxes applied to tobacco products (codification).EU Council Directive dated 21 June 2011 (2011/64/EU). -URL: <http://www.minjust.gov.ua/45885>.

indicator in 2012-2018 in the post-socialist countries of the EU (Table 4.2).

Table 4.2

**The dynamics of the minimum excise tax in the post-socialist
countries of the EU in 2012-2018**

	Countries	Value, EUR				Growth rate over the entire period, %
		2012	2014	2016	2018	
1	Bulgaria	75.67	75.67	82.32	90.50	19.60
2	Estonia	80.00	90.00	97.20	115.38	44.23
3	Latvia	73.32	85.60	93.70	109.20	48.94
4	Lithuania	67.19	74.14	85.00	96.00	42.94
5	Poland	74.89	92.86	97.88	98.24	31.17
6	Romania	76.50	79.00	94.61	94.88	24.02
7	Slovakia	88.50	91.00	91.00	96.50	9.04
8	Slovenia	90.00	106.00	106.00	111.00	23.33
9	Hungary	75.72	84.14	89.51	93.76	23.82
10	Croatia	n/a	78.59	84.82	92.84	n/a
11	Czech Republic	84.41	87.73	92.74	101.17	19.86
	EU-11	78.62	85.88	92.25	99.95	28.65

Source: Excise Duty Tables. Part III – Manufactured Tobacco. European Commission. 2012 URL: https://circabc.europa.eu/sd/a/f0f5445c-c154-4524-905f-0f8c15984494/Excise_Duty_Tables%20-%20III-Tobacco_July2012_REV1.pdf; Excise Duty Tables. Part III – Manufactured Tobacco. European Commission 2014. URL: https://circabc.europa.eu/sd/a/7daee41d-f33d-420e-96ac-e01020693795/III-Tobacco_July2014%20_final.pdf; Excise Duty Tables. Part III – Manufactured Tobacco. European Commission. 2016. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/excise_duties-part_iii_tobacco_en.pdf; Excise Duty Tables. Part III – Manufactured Tobacco. European Commission. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf.

If in 2012, the minimum excise duty in the analysed eleven countries reached EUR 90 per 1,000 cigarettes only in Slovenia, then in 2014, there were four such countries – Estonia, Poland, Slovakia joined the leader (despite the fact that a transition period was in place for Estonia and Poland). In 2016, the minimum excise burden even slightly exceeded the indicated level in Latvia, Romania and the Czech Republic. Bulgaria, Lithuania, Hungary and Croatia, which made the necessary strengthening of the fiscal role of cigarette taxation during the maximum permitted terms proved to be outsiders in reaching this harmonised standard. In 2018, Estonia, Latvia, Slovenia and the Czech Republic increased the minimum excise duty over EUR 100 per 1,000 cigarettes, reaching an average of EUR 99.95

per 1,000 cigarettes in the post-socialist countries of the EU.

In 2012-2018, the minimum excise duty on these excise goods grew most in Lithuania (by 42.94%), Estonia (44.23%) and Latvia (by 48.94%). At the same time, the corresponding average indicator in EU-11 was 28.65%. It is also important to add that in Latvia the increase in the minimum excise duty in 2012-2016 by 27.79% was accompanied by increase in cigarettes excise tax by 27.67%. In Lithuania, such growth rates were 26.51 and 35.76% respectively, in Estonia – 21.50 and 20.23% respectively⁴⁹. This testifies to the fact that the fiscal objectives of the policy of increasing excise tax rates for tobacco products have been achieved in the Baltic States.

For comparison: in Ukraine in 2018-2024 (also for 6 years) the legislation provided the growth of the minimum excise tax liability from 773.20 to 2,308.75 UAH for 1,000 cigarettes, i.e. almost three times. This will happen to achieve the minimum excise duty of EUR 90 per 1,000 cigarettes, despite the fact that the domestic economy is in a state of unstable post-crisis recovery, and the Association Agreement does not set the terms for raising excise tax rates for tobacco products in Ukraine to a level not lower than minimum EU rates. So it should be noted that tobacco companies in the EU countries are given the opportunity to adapt to the consequences of the increase in excise taxes, unlike in Ukraine. Moreover, the previous domestic strengthening of the fiscal role of the excise tax for cigarettes was accompanied by a significant delay in the increase rate of excise tax revenue from rate increase rate, as discussed in Section 3.

Thus, the analysis of the policy of strengthening the fiscal role of cigarettes excise tax in Ukraine in the context of the experience of the European Union countries gives grounds to conclude that the domestic legislatively regulated schedule for increasing the specific rate and the minimum excise tax liability for these tobacco products in 2019-2025 is tight and should not be revised for acceleration (in particular, by adjusting for the inflation index) or increasing the ad

⁴⁹ Excise Duty Tables. Part III – Manufactured Tobacco (Tax receipts – Manufactured Tobacco). European Commission. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties_tobacco_en.pdf.

valorem rate. The refusal from more dynamic strengthening of the fiscal role of tobacco products excise tax is also important due to the need to comply with the stability requirement when formulating and implementing the tax policy of the state.

In the EU countries, the total burden of excise and VAT for cigarettes is also significantly different. In 2018, these consumption taxes in the united Europe amounted to at least EUR 98.75 (in Lithuania) for the average weighted retail selling price of these tobacco products per 1,000 cigarettes. This maximum figure was recorded in Ireland at EUR 503.50. At the same time, in 2010, the combined tax burden varied from EUR 64.00 per 1,000 cigarettes in Poland to EUR 260.98 per 1,000 cigarettes in Ireland⁵⁰. Since Ukraine's average weighted retail selling price of cigarettes is currently not calculated, it is difficult to make the correct comparisons with the EU countries. At the same time, despite this European trend of a fiscal-oriented transformation of tobacco products taxation, it is important to emphasise that the excise policy of our state should not be aimed at the speedy approximation of the domestic indicator of the aggregate tax burden for cigarettes to analogues of the EU countries.

Simultaneously with the search for the best solutions related to reformation of the excise taxation of tobacco products in Ukraine, taking into account the requirements of EU directives and European experience, the problem for our country was the introduction of a domestic "invention" in 2015 – an excise tax on the retail sale of excisable goods in the amount of 5% of their price (including VAT and excise tax). Such retail tax by its very nature is not an excise tax and is credited to local budgets. As indicated in Section 1, in accordance with Article 1 of Council Directive 2008/118/EU, it is possible to tax other indirect taxes for "harmonised" excise goods (item 2) and services for the sale of excisable goods (item 3). But the retail excise tax in Ukraine does not have a legally established

⁵⁰ Excise Duty Tables. Part III – Manufactured Tobacco. European Commission. 2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_p_odu_cts/rates/excise_duties-part_iii_tobacco_en.pdf.

purpose and is not a tax related to the service of sale⁵¹ (there is a conflict with the requirements of the Directive). In addition, the above transformation does not correspond to the need to raise the rates of the domestic "standard" excise tax for "harmonised" excisable goods to a level not lower than the corresponding minimum rates in the EU. Also, we note that the mechanism for collecting retail excise taxes is associated with a high risk of tax abuses (especially if the sale of excise goods is carried out by small traders). Therefore, the objective is to abandon the excise tax on retail sales in favour of raising the rates of "standard" excise tax (specific tax rates for tobacco products).

In 2017, the excise tax for the retail sale of petroleum products was abolished. At the same time, such an initiative on retail excise duties for tobacco products faced a significant opposition from local authorities, since the abolishment of this tax implies a reduction in their budget revenues. Even the proposal to credit some part of the "standard" excise tax revenues into local budgets did not find support at local level due to the fears that the corresponding financial flow from the state budget would be lower than the revenue from the retail excise tax. The problem is still quite serious. As one of the possible ways of its solution, it is proposed to combine the complete abolition of retail excise tax with an increase of the share of personal income tax revenue to local budgets from 60 to 70%⁵². This will ensure elimination of the contradiction of the tax legislation of Ukraine with the requirements of Art. 1 of Council Directive 2008/118/EU and reduction of tax losses from the illegal sale of excisable goods in the conditions of formation of a stable financial basis for the functioning of local authorities.

Another fiscal compensator for local budgets may be the improvement of property taxation. It will also expand the resource base of local budgets and thus

⁵¹ As an example of an indirect tax related to the sale of excisable goods, you can charge a tax for bottling alcoholic beverages that was previously implemented locally in Germany. The service provided for the provision of a special place for the consumption of excisable goods and provision of service to a customer by a barman or a waiter. So the obligatory characteristic of such an indirect tax needs to be the availability of additional conditions for customer service when selling excisable goods.

⁵² The Association of Ukrainian Cities proposes to leave 70% personal income tax at local level UNIAN. URL: <https://economics.unian.net/finance/10240740-germaniya-rassmatrivaet-vozmozhnost-okazaniya-finansovoy-pomoshchi-turcii-smi.html>.

create prerequisites for the abolition of this pseudo-specific excise duty. The fiscal potential of property tax in Ukraine, particularly related to individuals, is utilised in full scope. In 2016, GDP share related to property tax in Ukraine was 1%, while in a number of European countries it reached 5% (for example, in Belgium – 3.6, Greece – 3.2, Spain – 2.7, France – 4.7, Great Britain – 4.3%).

At the same time, due to the reformation of the Ukrainian State Fiscal Service authorities, the functions of tax administration were transferred to regional departments, and instead of district and inter-district State Tax Services taxpayer service centres are operating. Local tax administration is now hampered by objective reasons, as it is often carried out without effective communication between fiscal authorities and local authorities, who make decisions about the rates and base of property taxation. At the same time, according to OECD estimates, specified in the report "Maintaining the pace of the decentralisation process in Ukraine" (2018), the main financial sources for the united territorial communities are subventions and transfers, and only about 30% of their income is formed by taxes and fees.

The important role in improving the excise policy of Ukraine should be taken away from measures to prevent fiscal mismanagement and avoid taxation. Implementation requires partially tested tobacco market control tools. First of all, this is related to the introduction of systems for monitoring the movement of tobacco products from the manufacturer to the end user. In addition, the need to counteract dumping, as well as the improvement of anti-forestalling tools, is urgent. The introduction of such measures will improve the situation with the collection of excise taxes, which will create conditions for abandoning the practice of paying taxes when purchasing tax stamps, i.e. before the start of production of tobacco products, weakening the negative impact of raising excise taxes for the development of the tobacco industry.

In order to stabilise excise taxes in Ukraine from 2016, the mere entry into force of the provisions of the Tax Code was not enough, according to which the Cabinet of Ministers of Ukraine was given the authority to establish minimum

wholesale and retail prices for tobacco products, tobacco and its industrial substitutes. The aforementioned innovation was a reaction to the reduction of cigarettes prices by individual tobacco companies, which reduced tax revenue and distorted market competition. However, this legislative provision contradicted the requirements of Art. 15 of Council Directive 2011/64/EU on the free determination of maximum retail price⁵³. At the same time, with an increase in the excise duty for cigarettes by 40% in 2016 and 2017, by 30% in 2018, dumping prices have increasingly distorted the competition in the market and limited the achievement of fiscal and regulatory excise policy objectives. The situation will be further complicated by the growth of excise tax rates for tobacco products by 20% annually in 2019-2025. In this regard, it is important for Ukraine to develop an anti-dumping mechanism to ensure the stability of tax revenues from cigarettes, taking into account the European experience described in Section 2.

We would like to emphasise that reducing domestic prices for tobacco products is particularly undesirable, as it leads to a lack of income received by the state in the face of acute shortage of fiscal resources and severe restrictions related to the growth of the budget deficit. At the same time, it is important to take into account a number of national economic and institutional realities when introducing an anti-dumping mechanism for stabilising tax revenue from cigarettes in Ukraine based on European experience.

Firstly, in accordance with Annex XXVIII of Chapter 4 "Taxation" of Section V "Economic and Industrial Cooperation" of the Association Agreement with the EU⁵⁴ it is required to necessarily approximate the legislation of Ukraine to the provisions of Council Directive 2011/64/EU within 2 years from the date of entry into force of Agreement (except for Articles 7(2), 8, 9, 10, 11, 12, 14(1), 14(2), 14(4), 18, 19 for which the implementation schedule will be established later

⁵³ Sokolovska A. M. Podatkovi aspekty YeS acquis yak oriientyry vdoskonalennia aktsyynoho podatku v Ukraini [EU tax acquis aspects as a guide for improving excise tax in Ukraine]. *FinancyUkrainy*. 2016. No. 12. 30-

⁵⁴ Association Agreement between Ukraine, on the one hand, and the European Union, the European Atomic Energy Community and their member countries, on the other hand: dated 21 March, 27 June 2014.URL: http://www.kmu.gov.ua/control/publish/article?art_id=246581344.

by the Association Council). Compliance with the provisions of the Directive, which are not listed as an exception, should be ensured today (this issue is described in details in section 1).

Secondly, the provision of the Tax Code of Ukraine for calculating the weighted average retail selling price of cigarettes will begin to be applied in 2025.

Thirdly, the practice of tax evasion is more widespread in Ukraine, rather than in the EU countries. At the same time, the dynamic increase of cigarettes excise duty by 20% each year in 2019-2025, aimed at achieving the European minimum excise standard of EUR 90 per 1,000 cigarettes, will increase the scope of their illegal traffic, shadow production and sales.

Fourthly, in domestic realities, it is better to avoid the use of mechanisms that greatly complicate (increase) tax administration for both fiscal authorities and taxpayers.

To resolve the problem of distortion of the fiscal and regulatory impact of excise policy as a result of decreasing prices on the tobacco market, stabilising excise tax revenues and improving their forecasting in line with the requirements of Council Directive 2011/64/EU, the Ministry of Finance of Ukraine developed a bill ensuring amendments to item 221.2 of Art. 221 of the Tax Code of Ukraine. The following paragraph was proposed to be added to this provision: "During the ascertainment of the tax liability in respect of cigarettes according to the code under UKT ZED 2402 20 90 20, the amount of declared maximum retail price of which is lower than the amount of minimum excise tax liability (in terms of the amount of cigarettes in a pack) multiplied by a coefficient of 1.65 the amount of excise tax must not be lower than the established minimum excise tax liability multiplied by a coefficient of 1.4"⁵⁵.

Analysing such an innovation, it can be stated that it corresponds to modern European trends in the application of an anti-dumping mechanism for stabilising

⁵⁵ On Amendments to Article 221 of the Tax Code of Ukraine regarding the Taxation of Tobacco Products of the Draft Law of Ukraine "On Amendments to Article 221 of the Tax Code of Ukraine regarding the Specifics of tobacco products taxation. URL: <https://www.minfin.gov.ua/news/view/proekty-rehuliatorykh-aktiv-dlia-obhovorennya-category=aspekti-roboti>.

excise tax revenues. It resembles the Spanish system for raising the minimum cigarettes excise duty, the maximum retail selling price of which does not reach a certain level determined by law (but there is no shortage of the Spanish model related to the legal regulation of fixed amounts).

At the same time, it is important to find out: 1) whether the use of coefficients of 1.65 and 1.4 in the proposed domestic fiscal mechanism is justified; 2) what goals can be achieved by implementing the relevant legislative initiative; 3) whether it has the advantages of using an anti-dumping mechanism in Ukraine developed by the Ministry of Finance in comparison with the German analogue, which is based on the determination of the aggregate tax burden for the weighted average cigarettes retail selling price and does not involve the use of coefficients.

In order to verify the validity of applying the coefficient 1.65 to the minimum excise tax liability for paying the excise tax on cigarettes in determining the threshold of their maximum retail selling price, which provides for the payment of a minimum excise tax liability with a coefficient of 1.4, compare the "non-tax" part of the cost of a pack of cigarettes at the weighted average retail price in the post-socialist countries of the EU and a "non-tax" part of a pack of cigarettes priced at USD 25.50 in Ukraine in 2018.⁵⁶ Unlike the price of cigarettes and the amount of taxes in it, which largely depend on the market situation of tobacco products (including the purchasing ability of smokers) and the tax policy of the state, the weighted average retail price of cigarettes, less all taxes, illustrates the cost of production and the cost of the selling these excisable goods, as well as the rate of tobacco companies profit. This "non-tax" part of the price of cigarettes can not fall below the economically sound level, the significance of which can not differ considerably in Ukraine and post-socialist countries of the EU, especially the least developed ones.

According to calculations (Table 4.3), the average weighted retail selling price of a pack of cigarettes in the post-socialist countries of the EU in 2018 ranged

⁵⁶ This price is the limit for the application of anti-dumping mechanism developed by the Ministry of Finance.

from UAH 78.64 in Bulgaria ⁵⁷to UAH 109.85 in Hungary (within the range of 39.7%; the operation of the single market restricts such variation) and averaged to UAH 100.12. At the same time, the "non-tax" part at that price was the lowest (UAH 11.93) in Bulgaria, having one of the highest tax burden for cigarettes in relative terms among the analysed countries, and the highest (UAH 29.07) in Romania, where a fairly loyal tobacco products taxation policy is implemented. Romanian tobacco companies had significantly better opportunities for profitable activity than the Bulgarian ones, according to almost the same average weighted retail price. The weighted average retail price of a pack of cigarettes less all taxes was also relatively low in Estonia (USD 15.30) and Latvia (UAH 15.61) and equaled UAH 20.17 on average in EU-11.

Table 4.3

The structure of the weighted average retail selling price of a pack of cigarettes in the post-socialist countries of the EU in 2018

Countries	Average weighted retail selling price		Share of excise duty and VAT at weighted average selling price of cigarettes, %	The weighted average retail selling price less all taxes	
	EURO	UAH*		EURO	UAH*
Bulgaria	2.57	78.64	85.09	0.39	11.93
Estonia	3.55	108.63	85.82	0.50	15.30
Latvia	3.20	97.92	83.99	0.51	15.61
Croatia	3.19	97.61	79.91	0.64	19.58
Poland	3.20	97.92	80.04	0.64	19.58
Lithuania	3.18	97.31	79.46	0.65	19.89
Slovenia	3.51	107.41	81.28	0.66	20.20
Slovakia	3.23	98.84	77.88	0.71	21.73
Czech Republic	3.31	101.28	78.31	0.71	21.73
Hungary	3.59	109.85	75.22	0.89	27.23
Romania	3.46	105.88	72.56	0.95	29.07
The average in EU-11	3.27	100.12	79.96	0.66	20.17

*As per exchange rate of the National Bank of Ukraine as of July 10, 2018, which is 1 : 30.6.

Source: calculated by the authors according to Excise Duty Tables. Part III – Manufactured Tobacco. European Commission. 2018. URI: https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf.

⁵⁷ In Bulgaria, cigarettes are much cheaper than in the rest of the European Union. Lithuania is the penultimate in the EU according to the cost of cigarettes, where the average weighted retail selling price of the pack was UAH 18.67 higher than in Bulgaria. The last one is one of the EU countries which is the closest to Ukraine in terms of economic development.

In 2018, in Ukraine, the price of cigarettes at the level of UAH 25.50 included VAT in amount of UAH 4.25 ($25.50/6$), excise duty is UAH 15.46 (minimum excise tax obligation to pay excise tax equivalent to a pack of cigarettes), the value of the excise stamp is UAH 0.09, and the "non-tax" part is 5.70 UAH ($25.5 - 0.09 - 15.46 - 4.25$). This figure is 2.09 times lower than the weighted average retail price of a pack of cigarettes less all taxes in Bulgaria and 3.54 times lower than the corresponding average in the EU-11. Therefore, if in Ukraine in 2018 the maximum retail price of a pack of cigarettes is declared at a level lower than UAH 25.50, then there is reason to assume that the tobacco manufacturing company is trying to avoid tax payments. Since the facts of selling cigarettes, the maximum retail price of which is even lower than the excise tax and VAT charged by the legislation in Ukraine, it can be stated that the practice of evasion from cigarettes excise taxation is extended. Implementation of the relevant legislative initiative by the Ministry of Finance can serve as one of the tools to combat such legal abuses.

The following must be noted. In case of the introduction of anti-dumping mechanism in Ukraine according to the German model, an additional excise duty would be paid from all cigarettes, the price of which is below their average weighted retail selling price. Assuming that this price (calculated on the basis of data on prices and volumes of sales of these excisable goods in 2017, as provided for by Council Directive 2011/64/EU) is UAH 24⁵⁸ in 2018, then cigarettes with price of UAH 23.99 per pack would be subject to additional excise taxation. In Ukraine in 2018, the ad valorem excise tax rate is actually applied to cigarettes, the maximum retail selling price of which exceeds UAH 32.54. However, this does not prevent some manufacturers from declaring maximum retail prices, in which the "non-tax" part tends to zero or even acquires negative values. Such low prices are economically unwarranted (dumping strategies are primarily implemented through tax abuses), but they are declared, which makes it possible to sell the appropriate

⁵⁸ As already mentioned, according to estimates of the Ukrainian Center for Tobacco Control, the average price of a pack of cigarettes in Ukraine in 2017 amounted to UAH 23–24.

"gray" tobacco products at legal sales points.

In case of introduction of the German model of anti-dumping fiscal mechanism in Ukraine, the estimated excise tax and VAT for a pack of cigarettes at an average weighted retail price of UAH 24 would be UAH 18.44 ($1577.98 / 20 / 1,000 + 24 \cdot 0.12 + 24/6$ or $11.56 + 24 \cdot 0.12 + 24/6$). Accordingly, for a pack of cigarettes with a maximum retail price of UAH 20, the estimated additional excise duty would be UAH 1.18 ($18.44 - 11.56 - 20 \cdot 0.12 - 20/6$), and the general estimated excise duty would be UAH 15.14 ($11.56 + 20 \cdot 0.12 + 1.18$). As this figure is lower than the minimum excise tax liability equivalent to a pack of cigarettes – UAH 15.46⁵⁹, the actual additional payment would be zero. So the introduction of this anti-dumping mechanism of stabilisation of excise tax revenue in our country would have no fiscal effect nor regulatory influence. This tool is effective in Germany, where excise rates are relatively stable and there is no surge growth of the weighted average retail selling price of cigarettes as a result of the increased fiscal role of excise taxation. Instead, in Ukraine, the excise duty for cigarettes in 2018 increased immediately by 30% and will increase further in 2019-2025 by 20% annually.

It is also required to conduct similar calculations on the assumption of the average weighted retail selling price of a pack of cigarettes in Ukraine in 2018 at the level of UAH 30. Despite the fact that this price can hardly be considered realistic, we will use it to compare the results of calculations in two scenarios: close to reality and optimistic. Estimated excise duty and VAT for a pack of cigarettes at an average weighted retail price of UAH 30 would be UAH 20.16 ($11.56 + 30 \cdot 0.12 + 30/6$). Then for a pack of cigarettes with a maximum retail price of UAH 20, the estimated additional excise tax would amount to UAH 2.87 ($20.16 - 11.56 - 20 \cdot 0.12 - 20/6$), and the general estimated excise tax would be UAH 16.83 ($11.56 + 20 \cdot 0.12 + 2.87$). The actual additional payment of excise duty would be UAH 1.37 ($16.83 - 15.46$). At the same time, the declaration of the

⁵⁹ Since Ukraine has a fixed amount of not minimum aggregate tax, but minimum excise duty, the calculations are based on the latter.

maximum retail price of a pack of cigarettes at the level of UAH 28 would require the payment of the actual additional excise tax in the amount of UAH 0,03 ($20.16 - 11.56 - 28 * 0.12 - 28.6 = 0.67$, $11.56 + 28 * 0.12 + 0.67 = 15.49$, $15.49 - 15.46 = 0.03$). For reference: when applying the domestic analogue of the anti-dumping fiscal mechanism, in such cases the amount of actually paid additional excise duty would be UAH 6.18 ($15.46 * 0.4$) and UAH 0, respectively. Consequently, in such very optimistic assumptions about the amount of average weighted retail price, the use of the German-based anti-dumping mechanism for stabilisation of excise tax revenues in Ukraine could hardly make it impossible to sell "gray" cigarettes in the legal market (tax surcharge in the amount of up to UAH 1.50 per pack of cigarettes is too low to reach this goal), but would increase the tax burden on cigarettes, the maximum retail price of which is lower than the weighted average one. The additional excise tax would have to be paid both by those who resort to tax abuses (but they may find new opportunities for fraud) and by tobacco companies which sell relatively cheap brands of cigarettes priced at up to UAH 29.99 and are conscientious taxpayers. Increasing tax burden on the latter is particularly undesirable in the context of a steady increase in excise tax rates. In addition, fiscal effects from applying such innovation could be rather insignificant due to the obvious significant complication of tax administration.

Both anti-dumping fiscal mechanisms (of Germany and those envisaged in the legislative initiative of the Ministry of Finance) have the same economic essence: if the maximum retail selling price of cigarettes falls below a certain level⁶⁰, it is necessary to pay the additional excise duty. However, unlike the German model, binding of the maximum retail price for cigarettes to the minimum excise tax liability with the use of economically feasible coefficient in domestic fiscal mechanism will significantly reduce the attractiveness of declaring the abnormally low, maximum retail prices that today makes it possible to sell suspiciously cheap cigarettes in legal points of sale without violation of the current legislation.

⁶⁰ There is no direct legislative ban for the manufacturer to freely choose price policy.

The disappearance of such a "gray" segment of the tobacco market of Ukraine will significantly impede access to cheap cigarettes (only the black market will offer them) which will contribute to the achievement of health care goals and increase tax revenues. Even if the application of additional excise tax will be very limited, the increase in average selling price for cigarettes in the legal market will create conditions for growth of VAT revenues, retail excise taxes and, in the measure of the increased prices for mid-price segment brands (tobacco companies can take advantage of this opportunity), ad valorem component of the excise duty. If their profits increase as a result of changes in cigarette manufacturers' price policy, there will also be an increase in income tax revenue⁶¹.

The introduction of the anti-dumping fiscal mechanism developed by the Ministry of Finance will also improve the predictability of excise tax revenue, reduce the risk of increase in the budget deficit and limit unfair competition in the tobacco market.

However, Article 7(2) and Article 8(6) of the Council Directive 2011/64/EU enable the application of the minimum excise duty on cigarettes which should be the same for all such tobacco products. The fiscal mechanism, developed by the Ministry of Finance, provides for the payment of a larger excise tax for suspiciously cheap cigarettes. However, in Annex XXVIII to Chapter 4 "Taxation" of Title V "Economic and Sector Cooperation" of the EU-Ukraine Association Agreement, the above provisions are attributed to the rules whose timetable for implementation will be subsequently established by the Association Council. In other words, Ukraine is not currently required to meet the aforementioned requirement of the common European law to full extent if this would be contrary to national interests. Therefore, there are no legal obstacles inhibiting implementation of the relevant initiative of the Ministry of Finance from 2019 (with a limitation on the term of application). On the contrary, the Association Agreement obliges our state to take measures to prevent tax evasion (including the illegal export of these excisable goods to the EU countries that lead to low prices for cigarettes).

⁶¹ Reducing loss ratio in economic activity will not provide such a fiscal effect.

Thus, the anti-dumping mechanism developed by the Ministry of Finance of Ukraine will ensure a significant reduction in attractiveness of declaring maximum retail prices for cigarettes, the "non-tax" part of which is lower than the minimum level of economically feasible indicators of production costs and sales costs, tobacco companies' profit margins, due to a rather substantial increase in the minimum excise duty. When introducing this instrument, cigarettes will not enter legal points of sales at the abnormally low price that will create preconditions for raising prices for these excisable goods with the corresponding increase in VAT revenues, the retail excise tax and, under certain conditions, the ad valorem excise tax and the income tax. Increased prices for domestic cigarettes will also limit their illegal exports to the European Union.

Other advantages of introducing the anti-dumping development from the Ministry of Finance are as follows: 1) decrease in availability of cigarettes which is important for the achievement of health care goals; 2) compliance with the provisions of the EU-Ukraine Association Agreement with regard to the implementation of Council Directive 2011/64/EU; 3) effectiveness in terms of a significant annual increase in excise tax rates (as opposed to the German analogue based on the use of the weighted average retail selling price); 4) easy administration; 5) there is no need to adjust the relevant legislative provision because there is no binding to fixed amounts; 6) creating conditions for improving predictability of excise tax revenues and reducing the risk of increase in the budget deficit; 7) restriction of unfair competition in the tobacco market.

Finally, we stress that the introduction of these measures proposed by us and other measures to improve the mechanism for collection of excise tax on tobacco products depends on whether the formation of a sufficient resource base of a consolidated budget, reduction in illegal circulation of tobacco products and effectiveness of implementation of regulatory potential of excise taxation will be ensured.

Conclusions

The conducted study about scientific approaches to reformation of the tobacco excise tax in the context of new challenges and threats, the experience of European Union countries in the field of collection of excise taxes on these goods, imbalances in the use of fiscal and regulatory potential of tobacco excise tax in Ukraine, and our state's obligations to introduce changes into tax legislation in order to introduce European integration strategy, as a whole, and to implement the EU-Ukraine Association Agreement, in particular, made it possible to substantiate a number of theoretical and practical conclusions and proposals. The main results of the writing staff's scientific research are as follows.

Based on the analysis of institutional environment impact (formal institutes, informal institutes, traditions, and values) on socioeconomic and fiscal processes, it has been proved that the requirements for the formation and implementation of excise policy should be as follows: readiness for compromise; complementarity of tax changes; rejection of radical tax initiatives; stability and flexibility. Compliance with these requirements is one of the conditions for successful implementation of the strategy for reformation of the excise tax.

In determining the directions to transform implementation mechanism for state excise policy, it was established that according to the EU-UKR Association Agreement, it is necessary to adapt Ukrainian tax legislation to the established norms of EU directives. Despite the numerous changes made, there are differences between the provisions of the Tax Code and the EU directives on the tobacco excise tax. This concerns, first of all, the structure of excisable goods of the relevant group with the observance of the time frame stipulated by the Agreement and achievement of European minimum taxation standards whose time limits are not currently established at the international level. The latter enables a gradual increase in rates.

When reforming the tobacco excise tax in Ukraine, it is important to take into account the EU experience. It has been established that in 2010-2018 all EU

countries, without any exception, have been increasing the specific excise rate for cigarettes. At the same time, the corresponding average rate in EU-28 was increased by a factor of 1.93, in EU-15 – by a factor of 2.04, in new EU countries – by a factor of 1.77. The average rates between the last two groups of countries in 2018 were distinctive by a factor of 1.71 since less developed countries have more limited opportunities to increase the fiscal role of excise duties compared to more advanced ones. The vast majority of EU countries (24) have been reducing the ad valorem excise tax rate for cigarettes.

In EU post-socialist countries in 2012-2018 (for 6 years), the minimum excise burden on cigarettes has increased the most in Lithuania (by 42.94%), Estonia (44.23%) and Latvia (by 48.94%). At the same time, the growth rate of corresponding excise tax revenue was not lower than the growth rate of the minimum excise tax which confirms the achievement of fiscal objectives of policy for raising excise tax rates for tobacco products.

In terms of the fiscal role of excise taxation for cigarettes, many European Union countries have experienced problems in collection of the planned excise taxes because of some tobacco companies' underpricing of cigarettes which have negatively affected the overall price increase. Germany has introduced one of the most effective tools to counteract such dumping. The country calculates excise tax and VAT for the weighted average retail selling price for cigarettes, which is the basis for comparison with the relevant indicators for the specific maximum retail price. If the aggregate specific, ad valorem excise taxes and VAT, in a particular case, are lower than such a minimum limit, the difference is payable as the additional excise tax.

In most EU countries, there was a need to apply anti-forestalling regulatory measures to equalise excise tax revenues during the year and to prevent accumulation of stocks with tobacco products containing tax stamps received before the rate increase. The main types of such measures are as follows: setting of quotas on the number of tax stamps released (cap on tax stamps); limitation of the volume of tobacco products which can be released for consumption (cap on release

for consumption); setting of the sale date (sell-by date), recalculation of excise tax liabilities as of the date of actual sale of the product to the consumer (paying the tax difference). The analysis of practices in EU countries shows that the effectiveness of anti-forestalling regulation has often been achieved not on the first try, sometimes through introduction of several measures simultaneously.

It has been established that in Ukraine, over the last years, excise tax rates on tobacco products have been increasing constantly, and also in recent years – by 30-40%. This was accompanied by a delayed growth rate from the growth rate of revenue of the corresponding excise tax, the increase in illegal circulation of excisable goods, price wars between tobacco companies, optimisation of taxation through purchase of tax stamps in advance and other unwanted occurrences. Accordingly, one can make assertions as to distortions of the fiscal and regulatory impact of the increase in excise rates.

The examinations of scientific principles, experience of EU countries and domestic practice in transformation of excise taxation on tobacco products show that, in the absence of fiscal resources in Ukraine, one of the main areas of improving the mechanism for tobacco excise tax collection should be a balanced and predicted increase in rates in preference to a specific component of the mixed taxation system.

The domestic schedule for increase in the specific rate and the minimum excise tax liability for these tobacco products in 2019-2025 by 20% annually (unlike modern European practice, more than 300% for the whole period) is rather rigid and should not be reviewed with regard to acceleration of the pace or addition through the increase of the ad valorem rate. At the same time, the indicated vector of fiscal-oriented excise policy of Ukraine is justified given that in countries with low cigarette prices, the focus on increase in the specific excise tax rate makes it possible to reach more quickly the minimum level of excise tax functioning in the European Union.

The problem for Ukraine is the use of domestic "invention" – excise tax on the retail sale of excisable goods, which intrinsically is not an excise duty, and its

legislative regulation is contrary to Article 1 of Council Directive 2008/118/EU. This tax should be canceled with compensation for the corresponding loss of local budget revenue at the expense of personal income tax or property taxes.

It is important to adopt the draft law prepared by the Ministry of Finance aimed at limiting legal sale of cigarettes, the maximum retail price of which, after taxation, is lower than the minimum economically feasible indicators of the cost of production and sales costs, the norm of profit. It is proved that introduction of the proposed anti-dumping instrument will reduce tax evasion and create preconditions to raise prices for cigarettes with corresponding increases in VAT revenues, the retail excise tax and, under certain conditions, the ad valorem excise tax, and the income tax. Furthermore, introducing this excise innovation in Ukraine leads to the following benefits: reducing the attractiveness of illegal export of tobacco products to the EU countries; compliance with the provisions of the EU-Ukraine Association Agreement with regard to the implementation of Council Directive 2011/64/EU; effectiveness in terms of a significant annual increase in excise tax rates (as opposed to the German analogue based on the use of the weighted average retail selling price); easy administration; there is no need to adjust the relevant legislative provision; creating conditions for improving predictability of excise tax revenues and reducing the risk of increase in the budget deficit; restriction of unfair competition in the tobacco market.

Starting from 2015, the annual increase in the excise tax rate for cigarettes, occurring in Ukraine on 1 January has led to the use of forestalling activities by tobacco companies. Losses of tax revenues from these actions in 2015-2017 amounted to UAH 66.7 to 139.9 mln. The analysis of effectiveness of the anti-forestalling regulation shows that solution to the tobacco stockpiling problem failed. Excise taxpayers have transferred the use of forestalling from the fourth quarter of the year to the third quarter. In view of this, it is necessary to restrict the sale of tax stamps starting from the third quarter of the reported year, and their maximum purchase volume should be calculated on the basis of the average monthly sales volume of tobacco products of the previous year adjusted for the

growth rates of the tobacco market of the previous periods. Moreover, in wholesale and retail trade it is expedient to limit the period of circulation of tobacco products with tax stamps, purchased in the previous year, up to three months.

The introduction of these and other measures to prevent fiscal abuse and tax evasion will improve the situation on collection of excise tax on tobacco products that may create conditions for refusal from the practice of tax payment when purchasing stamps, i.e., before the production of tobacco products, weakening the negative impact of raising excise tax rates on the development of tobacco industry. At the same time, in the short term, in order to reduce the diversion of working capital of taxpayers, further prolongation of the period for advance payment of the excise tax to the budget plays an important role.

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Annexes

Compliance of anti-forestalling measures of various types with the main principles of excise taxation

Characteristics of the measure	Harmonisation with the EU Excise Directives	Adaptation to the tax system of the EU Member States	Easy administration and control	Influence on the functioning of the market
1	2	3	4	5
Type I Setting quotas for volume of excise stamp orders (cap on tax stamps)				
During the tax period, setting limits on the volume of excise stamp orders. Such limitations are usually calculated based on the amount, increased by a certain percentage, of excise taxes received in previous periods. In some countries there are exceptions to this rule, in order to order more tax stamps, special permissions are required.	In accordance with Article 39 (3) of Directive 2008/118/EC, quotas for obtaining tax stamps may be set if this does not hinder the free movement of excisable goods.	This measure is easily adapted to the taxation system provided that the system for marking of tobacco products is used in the country. It could not be considered as the basis for development of the unified anti-forestalling regulation for European countries.	<p>The main advantage of such measures is the predictability and stability of tax revenue, easy and simple excise tax administration and control over the circulation of tobacco products.</p> <p>The main disadvantage of this model is the possibility to minimise tax excise liabilities by artificially increasing the orders for tax stamps before the start of limitation period.</p>	<p>The effectiveness of this measure depends on the duration of the base period, and, therefore, when setting quotas regarding the amount of orders for tax stamps, it is necessary to take into account the dynamics of the market, as well as the seasonality of the demand for tobacco products, and it is rather difficult to develop a system which takes this into account and does not affect the functioning of the market.</p> <p><i>The advantages</i> of such measures include the lack of incentives for minimisation of tax liabilities before raising excise tax rates.</p> <p><i>The disadvantages</i> of such anti-forestalling measure may be the following restrictions for:</p> <ul style="list-style-type: none"> – an increase in production volumes (due to restrictions on the order of stamps); – innovations and investments (since the number of tax stamps, which can be purchased, depends on the volume of orders made in the previous period, special mechanisms enabling the release of new products in the market are needed. In the absence of such mechanisms, innovations are limited, and investments in research and development activities are falling)

Annex A (continuation)

1	2	3	4	5
<p>The essence of this type of activity is to set a controlled period before the increase in excise tax rates, during which excise taxpayers may release a certain volume of tobacco products for consumption. This volume is calculated on the basis of the average quantity of tobacco products released for consumption during the previous reporting period.</p> <p>In practice, the release for consumption quota has the same effect as the quota for tax stamps but the difference lies in the use of tax stamps as a means of control over the quantity of products released for consumption</p>	<p>Type 2 Limitations on volumes of tobacco products which can be released for consumption</p> <p>Similar to measures with type 1, it is allowed to use them if this does not impede the free movement of excisable goods.</p>	<p>Measures of this sort can be applied in all tax systems. In countries which use tax stamps, quotas for production volumes should be consistent with the maximum volumes of tobacco products released for consumption in order to prevent the use of "old" tax stamps (except when tax stamps do not contain a reference to the price and have the same look which is used after change of the rate). Another problem is the poor quality of data on release for consumption of tobacco products. Since in most countries where tax stamps are used, the actual payment of the excise tax is based on the marking, and the control mechanisms are related to the purchased tax stamps but not at the time of release for consumption.</p>	<p>Following the increase in excise tax rates, such a type of measures limits the amount of tobacco products which can be released for consumption which in turn makes it possible to limit the instability of tax revenue caused by forestalling. Unlike setting of quotas for excise stamp orders, limitation of the volumes of tobacco products which can be released for consumption is a relatively easy approach as data on previous volumes of tobacco consumption in the market are used. Therefore, the effectiveness of such a measure depends on the predictability of changes in excise tax rates. On the other hand, the structure of supply chain and the related time limits of production for consumption require timely disclosure of information on changes in excise tax rates. The costs for administration of this measure are low.</p>	<p>As with the application of measures with type 1, it is necessary to take into account the market trend as well as the seasonality of the demand for tobacco products. Since this measure is applied only for a limited period of time and to all market participants, the impact on market functioning may be minimal provided that the limited period is short enough and changes in the excise duty rates are infrequent. Limiting the volumes of tobacco products which may be released for consumption could delay the penetration of new products into the market in the period preceding the change in taxation. In addition, this can force manufacturers to operate at a low level of production capacity.</p> <p><i>The advantage</i> of this type of activity consists in the fact that it does not incite manufacturers to the forestalling activities during the period after raising excise tax rates.</p>

Annex A (continuation)

1	2	3	4	5
Type 3 Setting a sell-by date (hereinafter referred to as "sale date"); 3a. "Sale date" for wholesale (sell-by date at wholesale)				
<p>The use of a controlled period for sale by manufacturers, importers and wholesalers of tobacco products taxed at excise tax rates effected before the increase. Such tobacco products can not be sold to retailers after the end of this period but may be returned to the manufacturers, importers.</p>	<p>The application of this measure may hinder free movement of goods, that contradicts Article 39 of Directive 2008/118/EC, which does not provide for restrictions on the distribution of products after its release for consumption.</p>	<p>This measure fits the taxation system provided that identification means are in place that make it possible to determine the date of release for the goods in a free tax circulation. Thus, if a country does not use a marking system, there is a need to identify boxes/master cases of tobacco products. However, the system works independently of the excise marking.</p>	<p>The measure of this type applies to tobacco wholesalers, which are not usually numerous, and, therefore, its administration is relatively easy. The ease of use of the measure is that, after setting the final sale date, no packet of cigarettes may be sold by a wholesaler without the ability to manipulate or bypass a controlled period. Cigarettes, released for consumption but not sold to retailers by the end date, must be withdrawn from the market (returned to wholesalers), and excise taxes/VAT paid for them must be refunded.</p> <p>In addition, avoiding this type of activity is more complicated because of the establishment of a final sale date, and the impact on tax revenue is minimal. The application of this system requires clear criteria for differentiation of wholesale and retail trade, especially in those cases where they coexist in one legal entity or economic group.</p>	<p>This type of measure does not restrict the functioning of the market for existing and new products since no quotas for the production and circulation of tobacco products are set. Since tobacco products, released for consumption but not sold to retailers by the deadline, should be withdrawn from the market, the application of this measure leads to operating costs for manufacturers and wholesalers if the period between the announcement of the change in the excise tax rate and the sale date is insufficient to implement an appropriate plan for sale of stocks.</p>
3b: "sale date" in wholesale and retail trade (sell-by date at retail)				
<p>This type is similar to the previous type of measures, but it covers all stages of the supply chain.</p> <p>In the case of raising the excise tax rates for tobacco products which</p>	<p>The application of this type of measure is contrary to Directive 2008/118/EC (see substantiation to type 3a)</p>	<p>The measures are applicable to all taxation systems that provide for marking of tax stamps since differentiation is required for "old" and "new" taxable products.</p>	<p>The main difference between the measures of this type from the previous ones is that for all tobacco products sold to consumers after the final sale date, the amount of excise tax, calculated at new rates, must be paid. Thus, subject to the effective control, the negative impact of the forestalling on</p>	<p>This type of measure does not affect the functioning of the market for existing and new products. The number of cigarettes, which can be produced and released for consumption at any time, is unlimited provided that the appropriate taxes are paid for them.</p> <p>Cigarettes, released for consumption but not sold to final consumers before the final</p>

Annex A (continuation)

1	2	3	4	5
<p>released for consumption until the final date, they can be sold only for a limited period after such a change. Cigarettes, which are still stored by wholesalers and retailers at the end of the period, should be withdrawn from the market. It should be noted that some EU member states use different periods of restrictions for wholesalers and retailers.</p>			<p>tax revenues is minimal. From the point of view of administration, the implementation of this measure is much more complicated compared to "sale date" for wholesale since the control system should also include retailers. At the same time, the quantity of unsold products may be greater which will become an administrative barrier for market operators and will de-motivate forestalling.</p>	<p>sale date, must be withdrawn from the market. In order to reduce the risks associated with a limited sales period, retailers in some countries have a possibility to return all or part of the products to suppliers. Thus, the number of returns in the market may be significantly higher than for other types if the period between the announcement of the change in excise tax rates and the sale date is not sufficient for operators to implement the relevant plans for sale of stocks.</p>
4.4 Type 4:	recalculation of tax	liabilities on excise duty on	date of actual sale of goods to the consumer	paying the tax difference)
<p>Under this type of anti-forestalling measure, the operators are required to report on cigarette stocks taxed at the old rates of excise tax. Based on this, the difference in taxation must be calculated between the "old" and "new" excise tax to be paid.</p> <p>The information on the number of tobacco products, which have been already released for consumption but not yet sold to final consumers, is crucial since</p>	<p>This type of measure does not impose restrictions on free movement of excisable goods or imposes any quantitative restrictions on trade between EU Member States. However, as a result of change in the excise tax rate, an additional payment, which contradicts the generally accepted principles of excise taxation, is formed.</p>	<p>In all excise taxation systems. It must be emphasised that this measure is effective only in the absence of fiscal marking, and tobacco packs do not contain retail prices (while this is mandatory in some member states). Otherwise, for this type of anti-forestalling measures, an additional system is needed to collect the excise tax difference arisen as a result of the increase in the rate, i.e., the use of additional</p>	<p>This type of activity ensures coordination of budget and tax policy. Tobacco products not sold before the date of entry into force of the changes into excise taxation must be taxed in the amount equal to the difference between the old and the new excise tax.</p> <p>In order to ensure these measures, it is necessary to introduce a reporting and control system, according to which the presence of tobacco products in the warehouse is reported and an additional excise tax is announced. However, taking into account the number of operators and the complexity of control, the risk of tax evasion is quite high.</p>	<p>It does not affect the functioning of the tobacco market. An unlimited number of tobacco products can be manufactured and released for consumption at any time, and the applicable excise tax rate is the same for all similar products regardless of when they are released for consumption in the future.</p> <p>In those Member States (16), where the retail price is shown on a pack or fiscal mark, this type of measure is likely to result in large volumes of additional market profitability.</p>

Annex A (continuation)

1	2	3	4	5
<p>an additional payment must be enforced for them. Cigarettes released for consumption after the date of change in the tax rate will be taxed with the application of the new excise tax.</p> <p>In some EU member states, the prices for tobacco products, which have been already released for consumption, are fixed and can not be changed even if the excise tax increases.</p> <p>Accordingly, the cost of the additional excise tax should be covered by the operator.</p> <p>This system can be used at wholesale level, as well as at wholesale and retail levels in general. In the second case, administrative costs are much higher, as well as the potential for entry into the market. Otherwise, the evaluation of these two systems is the same</p>	<p>Therefore, this type of anti-forestalling does not comply with the provisions of Directive 2008/11/EC which do not provide for the payment of excise tax after release for consumption.⁶²</p>	<p>fiscal labels or other options for reflection of prices</p>		

De/here/o: Tusveld R, Lejeune I, Bogaerts N. Study on fiscal anti-forestalling measures for the tobacco sector. PWC. 2013. 28 p.

⁶² Similar: European Commission, European Commission calls on Portugal to change its excise duty rules for cigarettes, Press Release, IP/12/675, Brussels, 21 June 2012.

Characteristics of anti-forestalling measures in the selected EU countries

Country	Anti-forestalling measures	Terms for implementation of the measure	Characteristics of the measure
1	2	3	4
Belgium, Luxembourg	Setting quotas for a number of released tax stamps " <i>Cap on tax stamps</i> "	Pre-notification of changes in excise tax rates should be made 3 months before this. 2 months earlier – official publication of new excise tax rates	Manufacturers and importers may require new tax stamps. The maximum annual quantity of tax stamps which can be obtained is 115% of the volume of released tax stamps of the previous year. During this period, manufacturers and importers of tobacco products may: – release products with "old" tax stamps; – order "new" tax stamps.
	Setting the final sale date in the wholesale trade " <i>Sell by date at wholesale</i> "	Within 60 days after the entry into force of new excise tax rates	Manufacturers can not release products with "old" tax stamps any more. Wholesalers may sell and deliver products with both old and new tax stamps.
Bulgaria	Setting quotas for a number of released tax stamps " <i>Cap on tax stamps</i> "	Official announcement of the new excise stamp – October 1 Official announcement of new excise tax rates – November 1 New excise rates and new tax stamps will come into force – January 1	A new design of the excise stamp is announced three months before start of its operation. In this case, licensed warehouse managers may order a maximum number of tax stamps which does not exceed 115% of the average sales volume in the previous 12 months. To order more tax stamps, a special customs permit to be reasoned is required. Within 3 months before the introduction of the new excise stamp and excise tax rate, the volume of the order must not exceed the average sales volume without a correction factor of 1.15.
Czech Republic	Setting the final sale date in retail " <i>Sell-by date at retail</i> "		After raising excise tax rates, products taxed at the old rates can be sold within 2 months after that (for cigarettes the sale date of at retail is 3 months). After this period, inventory should be made. Two months after that, unsold tobacco products are subject to elimination under customs control, and the cost of their tax stamps can be refunded to the entity.

Source: prepared by the authors on the basis of websites of EU fiscal authorities.

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