

CECCM¹ Briefing note: the *Eko-Tabak* judgment and the smoking test provided by the CN Explanatory notes

1. CECCM concerns over diverging interpretations following *Eko-Tabak* judgment

A. *The Judgment on Case C-638/15 – Eko-Tabak vs. General Directorate of Customs, Czech Republic*

The Court of Justice of the European Union (CJEU) delivered its judgment on 6 April 2017 ([here](#)) relating to a request for preliminary ruling on the interpretation of Articles 2 & 5 of Directive 2011/64/EU (“Excise Directive”) on the **definition of smoking tobacco**.

In this preliminary ruling, the CJEU ruled that Articles 2 and 5 of the Excise Directive “*must be interpreted as meaning that dried, flat, irregular, partly stripped leaf tobacco and/or parts thereof which have undergone **primary drying and controlled dampening, which contain glycerine and which are capable of being smoked after simple processing by means of crushing or hand-cutting**, fall within the definition of ‘smoking tobacco’ for the purpose of those provisions*”.

In addition, the CJEU quoted the definition of “smoking tobacco” in the context of the Excise Directive as “tobacco which has been cut or otherwise split, twisted or pressed into blocks and is capable of being smoked without further industrial processing”.

Taking together the definition in the Excise Directive² and the operative part of the CJEU judgment, “smoking tobacco” may only be understood as a product that fulfils the following two **cumulative** conditions:

1. “*That the tobacco be cut or otherwise split, twisted or pressed into blocks*”;
2. “*That it is capable of being smoked without further industrial processing*”

The CJEU clarified when tobacco may be regarded as being cut and otherwise split in the context of the first condition.³

With reference to the second condition, it is important to note that the CJEU found that this condition is satisfied when tobacco products have undergone primary drying and controlled dampening, contain glycerine and are capable of being smoked after simple processing by means of crushing or hand-cutting. Tobacco raw materials do not contain glycerine which is usually added during manufacturing process of semi-finished or final tobacco products.

With regard to the concept of “*industrial processing*” the CJEU concluded that “*manufactured tobacco which is ready or can easily be made ready [after simple processing by means of crushing or hand-cutting] to be smoked must be considered to be capable of being smoked without further industrial processing*”. Industrial processing, on another hand, takes place in the designated premises using specialized machinery.

¹ Confederation of European Community Cigarette Manufacturers, representing British American Tobacco (BAT), Imperial Tobacco Brands (IMB) and Japan Tobacco International (JTI).

² See Case C-638/15, *Eko-Tabak*, ECLI:EU:C:2017:277, para. 25, which focuses on the two cumulative conditions found in the Excise Directive.

³ Case C-638/15, *Eko-Tabak*, ECLI:EU:C:2017:277, para. 28 of the judgment: “[...] *in so far as the products [...] consist [...] of tobacco leaves which have been partly stripped in order to remove the petiole, those products must be regarded as tobacco which has been cut or otherwise split within the meaning of Article 5(1)(a) of Directive 2011/64*”.

Further, an important fact in the CJEU's analysis (and under the relevant Czech law) is that the smoking tobacco was "*prepared for sale to the final consumer*".⁴ The judgment is designed to respond to a specific illicit trade activity (tax evasion) by the Czech company. In fact, the company provided the smoking tobacco for sale to final consumers yet illegitimately claimed that it was raw tobacco in its failed attempt to escape payment of the excise duty on smoking tobacco under the Excise Directive. As the CJEU states, "[...] *those products were, in their entirety, intended for sale to the final consumer*"⁵. This is further supported by the Czech court which noted that the smoking tobacco was offered to final consumers who were even able to avail themselves of a leaf cutting machine on the counter of the shop⁶.

The *Eko-Tabak* judgment sets the guidance to counter a clearly illicit activity which is different from legitimate movement by economic operators of raw tobacco that is destined and in fact is used to manufacture finished tobacco products (which are then subject to relevant excise tax and VAT).

Considering the above, the authorities of the Member States have now sufficient guidance and grounds to levy excise duty when cut and split tobacco is destined for sale to final consumers.

Unfortunately, we notice that the judgment is misused in day-to-day practice by the authorities of some Member States who generally consider raw tobacco (not destined for sale to final consumer but for further processing in authorized tobacco manufacturing plants) as subject to excise based upon the provisions of the Article 5(1)(a) of the Excise Directive. With the following, we give a couple of examples and explain the practical consequences for the member companies of CECCM.

B. Different issues CECCM Members face in EU Member States

1. Germany

In September 2017, the Ministry of Finance issued guidelines to all German Main Customs Offices to ensure a common approach in assessing shipments of tobacco falling under the category of (other) smoking tobacco in line with the provisions of the German Tobacco Tax Law.

As a direct consequence, the number of the physical controls increased on the shipments of raw tobacco, with the authorities taking samples of the tobacco and seizing / confiscating the cargo in certain cases.

On 28 February 2018, the German Ministry of Finance also informed the main national tobacco trade federations (Deutscher Zigarettenverband, Verband der Rauchindustrie and Bundesverband der Zigarrenindustrie) that they will interpret the terms "smoking tobacco" very broadly. In fact, going forward, they will treat any tobacco that is somehow broken, cut or split as being capable of being smoked without further industrial processing which consequently means that these products are going to be treated as excisable.

This interpretation overlooks several phases of industrial processing other than "*cutting or otherwise splitting*" such as, *inter alia*, the necessary addition of glycerine in smoking tobacco, as recognized by the CJEU in the operative part of

⁴ Case C-638/15, *Eko-Tabak*, ECLI:EU:C:2017:277, para. 7, 8, 15.

⁵ Case C-638/15, *Eko-Tabak*, ECLI:EU:C:2017:277, para. 8.

⁶ *Eko-Tabak, s. r. o. vs. Generální ředitelství cel (General Customs Directorate)*, Nejvyšší správní soud (Supreme Administrative Court, Czech Republic), Brno, 24 August 2017, paras. 8, 37.

its *Eko-Tabak* judgment, and it creates obstacles to the free movement of goods to other EU countries where these goods are rightly considered as non-excisable and are generally subject to national monitoring measures.

2. Sweden

Sweden has faced during recent years a growing issue with raw tobacco sold at retail. The *Eko-Tabak* judgment provided the basis to tackle this issue; however, the manner chosen by the local authorities harmed the legitimate snus producers also.

For instance, a snus⁷ producer had its tobacco scrutinized and, although the customs classification under 2401 heading was upheld, some of the tobacco materials were considered as being subject to excise because Swedish Customs believed that they could be smoked without further industrial processing.

2. CECCM's views on the use of the smoking test to classify products for excise purposes

When it comes to customs and the import of goods into the EU, the Common Customs Tariff applies, which represents a combination of the classification of goods for customs purposes and the duty rates that apply depending on the economic sensitivity of the products.

Classification of the goods for customs purposes is determined based on the Combined Nomenclature ("CN") of the European Union which itself is based upon the Harmonized System ("HS"), a coding system for commodities which is applied by most of the trading nations around the globe, under the auspices of the World Customs Organization. Application of the CN is supported by Explanatory Notes to the HS and to the CN⁸, which provide guidance on the classification of products.

On the 6th of April 2016, an amendment to the CN has been published in the Official Journal of the EU, providing for a smoking test designed to distinguish between manufactured tobacco of heading 2403 and unmanufactured tobacco of heading 2401.

CECCM would like to express deepest concerns regarding whether or not the smoking test for tobacco and tobacco products should be used when determining if a certain tobacco material is capable of being smoked or can be smoked, in the meaning of Article 5 of the Excise Directive.

As expressed on earlier occasions, we regard the smoking test as unsatisfactory in its current form and welcome the opportunity to have it reviewed and refined. In this particular case, the smoking test may be used in practice to classify tobacco products as excise goods in breach of the definitions of the Excise Directive. This is done because the MS authorities may regard it as the only scientific tool available to indicate whether tobacco and tobacco products are ready for smoking without any further industrial processing.

An example of where the smoking test has been used to determine excisability is Sweden.

Swedish Customs detained five containers of raw tobacco for use in the snus factory of one of CECCM's members in August 2017. The purpose of this detainment was to take samples and determine if the tobacco fell within the description of smoking tobacco and should thus be

⁷ A type of moist powdered tobacco, held in the mouth between the lips and gums.

⁸ Explanatory notes to the Combined Nomenclature of the European Union, *Official Journal of the European Union*, C 76, 04.03.2015.

classified under a different customs tariff heading subject to a customs duty rate of 74.9%. We believe the motivation behind this unreasonable change in customs classification purposes derives from misapplication of the “smoking test” referred to in the CN Explanatory Notes.

Upon examination, three of the containers were found by Swedish Customs to contain goods determined to be classifiable as raw tobacco. Two containers, however, were found to allegedly contain material determined to be classified as smoking tobacco of heading 2403. Aside from the higher rate of customs duty, Swedish Customs determined that because of the customs classification of “smoking tobacco” it was also considered appropriate that the goods should be subject to excise duty and accordingly subject to associated excise controls.

Advocate General Kokott has already established that, in order to assess whether or not tobacco goods are covered by the Council Directive 2011/64/EU (the Excise Directive) and are therefore liable to excise duty, **“the determinative element is not the Combined Nomenclature, but Directive 2011/64”**.

3. Conclusion

All in all, it is important to note that the EU Commission, in its January 2018 report on the review of a possible revision of Directive 2011/64 opposed the application of excise duties to raw tobacco as a measure to fight illicit trade¹⁰. Application of a smoking test designed for customs classification purposes to determine that excise tax should allegedly be applied to raw tobacco meant for manufacture into finished goods is clearly against the Commission’s recent guidance on this matter.

Importantly, as highlighted in the key findings of Economisti Associati study¹¹, illicit trade of raw tobacco in the EU is estimated in a range between 0.8% to 1.2% of the EU raw tobacco market, and lost revenues on the amount of cigarettes which can be produced with illicit raw tobacco would amount to €1.2 to 2 bn (that is 1.6% to 2.7% of the current revenues from cigarettes).

Administrative and compliance costs for growers and first processors are expected to be significant and would represent a cost increase of 35% compared to the current price of raw tobacco. With respect to the EU raw tobacco market, additional regulatory costs would amount to 8% of its value. Therefore, the inclusion of raw tobacco among excisable products seems to be a disproportionate response, given the amount of costs associated.

4. CECCM’s suggestions to the Member States

In the light of all the above, we therefore respectfully suggest to the Member States:

1. To properly apply the two cumulative conditions outlined in EU law and discussed above (and not to rely on customs classification rules) when analysing whether some tobacco products are “smoking tobacco” for excise purposes.
2. To consider the *Eko-tabak* judgment in its context, which was to tackle the abuse of the system (intentional misdeclaration by a manufacturer of goods that were manufactured and prepared for retail sales; i.e. as unmanufactured tobacco to evade excise duties). In particular, the industrial processing of primary drying, controlled dampening and addition of glycerine should be given due relevance in such analysis.

⁹ Opinion of Advocate General Kokott in Case C-409/14, Schenker, ECLI:EU:C:2016:76 *para* 82.

¹⁰ Report from the Commission to the Council on Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco, COM(2018) 17 final, Brussels, 12.1.2018, pp. 4-5.

¹¹ [Economisti Associati](#) Study on Council Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco, Final Report, May 2017, p.163.

3. To avoid unnecessary complexity to enforcement of excise legislation as well as the legitimate manufacturing processes.
4. To properly enforce the existing legislation – this approach would solve many issues (e.g. direct sales at retail with machines in shops to cut the tobacco or instructions how to do it at home).
5. In case increased monitoring of the supply chain would be desired, to consider an alternative which is more efficient than the inclusion of unmanufactured tobacco under EMCS, i.e. a licensing system at Member State level. Such systems are currently successfully applied in Denmark, Ireland, the UK, Czech Republic, Poland and Romania – and have solved the local problems by penalising those involved in the handling of unmanufactured tobacco outside the licensing system.