APTF ASEAN Excise Tax Study Group

26 August 2013

DISCUSSION PAPER

including tobacco, alcohol, non-alcohol & automotive chapters

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EXECUTIVE SUMMARY

The following paper represents the most comprehensive analysis of excise taxation of the ASEAN region ever undertaken. Based on the most accurate information on excise tariffs and other taxing instruments, as provided by the 10 Ministries of Finance, a detailed examination has been conducted on the various approaches to excise taxation within the region. As expected, there was a diverse approach to both the range of goods and services subject to excise and in the approaches to levying the excise, and these are highlighted in the 'overview' chapter.

The analysis has been conducted in the context of looking to develop a level of standardization of key areas of excise taxation such as the classification and defining of goods and services subject to excise, as well as standardizing areas such as tax bases and administration, using 'best practice excise taxation' to steer the analysis. Eventually, this discussion paper will form the basis of a resource that will be available for tax policy makers in the region to utilize in any future excise tax reforms, a resource that will lay out how best to identify, classify, define and to tax those goods the government has chosen to subject to excise. With all ASEAN member Ministries of Finance utilizing the resource, it is anticipated that a level of standardization will start to enter excise taxation in the region.

Standardization will become increasingly important as the region moves towards AEC which is due to commence on 31 December 2015. Standardization of areas such as definitions and tax bases will improve the intra-regional trade of excisable goods across the region, as well as in many cases, improve compliance in the distribution of these goods in the region. The process however, does not wish to discuss national tax sovereignty, rather how to better reflect existing excise policies.

The discussion paper not only has significant 'general' analysis of regional excise taxation, both policy and administration, but also undertakes a more detailed analysis of those goods most commonly subject to excise – tobacco, alcohol, automobiles and non-alcohol beverages, which can be found in chapter 5. The content of these particular product based sections of this particular chapter will greatly enhance the knowledge of any tax policy maker involved in the taxation of these types of goods.

The discussion paper does not contain recommendation, but rather asks questions of the 10 ASEAN Ministries of Finance. These questions when discussed and addresses, will help move this paper from a discussion document to the resource material by better understanding the regional and national issues that sit between today's excise tax systems – and 'best practice' excise tax systems.

The authors thank the contributions of each Ministry of Finance and welcome any comments on the paper, or comments against the specific questions below:

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1. OVERVIEW OF EXCISE TAXATION IN ASEAN

1.1 Current approaches to excise taxation in the region

Excise taxes represent different priorities for different countries across the 10 members of ASEAN. This is borne out by both the differing ranges of goods and services subject to excise, and in the approaches to levying excise. Excise taxes are designed to serve a range of revenue, health and social policy objectives, which differ from country to country across ASEAN. However, we do see commonality in a number of goods traditionally subject to excise on externality grounds, and these include alcohol beverages, tobacco products and motor vehicles.

Whilst revenue generation is clearly an objective of each excise tax system, there is increasing use of excise rate structures and rate differentials to meet other government policy areas related to the consumption of those goods and services. For example, these other objectives include the implementation of special categories for motor vehicles that meet certain environmental and fuel efficiency standards, or for fuel blends that burn cleaner in internal combustion engines.

ASEAN's 10 member countries have primarily designed excise tax systems to account for domestic policy interests. This raises several issues for policy makers, as ASEAN members increasingly work together to develop a regional approach to economic development. The move towards closer economic integration or the 'single market and single production base' of the ASEAN Economic Community (AEC) by the end of 2015, now starts to bring focus to some of the differences in excise tax policy (and administration) between the ASEAN membership countries. The impact of the AEC on regional excise systems is the driver of this study, and will be a significant consideration for the final product of the study, which will deliver a resource guide that is designed for use by ASEAN Ministries of Finance should they need to undertake any reform work ahead of AEC.

The AEC Blueprint aspires to standardize and, where possible harmonize, much of intra-regional trade. As such, much needs to be done to build upon existing commonalities, and to propose new standards to apply which will improve the environment for investment and trade in excisable goods in ASEAN. Importantly, such harmonisation should not impact the sovereign right of each member to set excises on its own ranges of goods and services at their own desired rates. The key elements of the AEC Blueprint will be discussed in more detail below.

At this point it is important to define 'excise taxation' as this is not a term used by all members of ASEAN despite the fact they all levy 'excise type' taxes. Therefore, **in this paper, the term 'excise' will relate to a form of indirect taxation which is applied to a narrow base of goods (and often services) being goods which are primarily 'luxury' or 'consumer-based' in nature.** Excise taxation is common throughout ASEAN, being an important component of the overall tax system of each member.

This approach is consistent with the classification of "excise taxes" by the OECD[1] which considers excise taxes to be those taxes which are:

> 'levied on particular products, or on a limited range of products …… imposed at any stage of production or distribution and are usually assessed by reference to the weight or strength or quantity of the product, but sometimes by reference to the value'

Excise is not a value added tax (VAT) or sales tax, which the OECD differentiates by reference to the application of such taxes (and tax credits for business inputs) at each stage or tier within the supply chain, as well as a generally broader tax base.[2] Unlike an excise, the sole objective of a VAT or sales tax is to raise government revenue from the domestic consumption of goods and services. Excise is not usually levied instead of such taxes, but rather levied in addition to such taxes.

It is also important to note that not all ASEAN members use the term "Excise tax" in their domestic taxation systems and therefore a range of taxes with other titles are included in this study. As such, this study defines excises across ASEAN in accordance with the OECD classification above. In this context, for example, it is noted that Vietnam has a "Special Consumption Tax" and Indonesia has a "Luxury Sales Tax" in addition to the Finance Minister's Excise Tax Decrees. Furthermore, Thailand levies both a "Liquor Tax" on alcohol beverage products and a "Tobacco Tax" on tobacco products, which is administered as an excise by an 'Excise Department' within its Ministry of Finance. Increasingly, several ASEAN members have been reforming these types of taxes and incorporating the term "excise' in many recent amendments.[3]

To begin analysis of these questions there needed to be some form of benchmarking of existing ASEAN excise systems. This proved to be a very difficult exercise given a lack of consistency across these regional excise systems. The main obstacles to a clear analysis and benchmarking of excise systems included:

- Differing ranges of goods (and services) subject to excise as set out in Table 1, which demonstrates that:
    - Only five products were found to be subject to excise (or equivalent tax) across all ASEAN member states and these were: passenger motor vehicles; beer; wine, distilled spirits; and packaged tobacco (cigarettes and cigars);
    - Another seven products and one service were found to be taxed in 'most' ASEAN member states; whilst

[1] OECD (2004) Classification of taxes and interpretative guide, paragraph 61, classification sub-heading 5121
[2] OECD (2004) Classification of taxes and interpretative guide, paragraphs 53-58, classification heading 5100, sub-headings 5110-5113
[3] See for example Indonesia reforming alcohol and tobacco items in the Luxury Sales Tax to be "Excise Tariffs", Vietnam to use the term 'excise' in reforms of alcohol and tobacco items of the Special Consumption Tax and Thailand's proposal to bring provisions of the Liquor Act and Tobacco Act into the general Excise Act.

- A further nine 'broad categories' of goods and service were taxed in at least one ASEAN member state.

Table 1: Scope of excise taxation in ASEAN

All Countries	Most Countries	At Least One Country
Beer	Gasoline	Non-alcohol beverages
Wine	Diesel	Kreteks
Distilled Spirits	Kerosene	LPG / CNG
Cigarettes	RYO tobacco	Ethanol
Cigars	Pick-up truck	Luxury goods
Passenger vehicles	Buses	Home electrical goods
	Motor cycles	Eco goods
	Night club venues	Gambling
		Golf/recreation

- Approaches to excise taxation in terms of the tax base vary between member states as is outlined in Table 2 below, and include:
    - value based or 'ad valorem' duties;
    - quantity based or 'unitary', 'specific' or 'volumetric' duties;
    - a mixture of both an ad valorem and a specific rate of duty; and
    - in the case of Thailand,[4] a mixed rate ad valorem and specific excise rate tariff in which the taxpayer calculates against both rates and pays the higher tax collection of the two.

Table 2: Excise tax bases in ASEAN

Use of Specific Rates	Use of Ad Valorem Rates	Use of Mixed Rates
Brunei	Cambodia	Malaysia
Indonesia	Laos PDR	Philippines (Spirits)
Philippines (Beer, wine,	Myanmar	Thailand (Greater of a specific or ad valorem rate for beer, wine, spirits,

[4] In many cases this value is actually set by the Excise Department itself in a system known as 'authoritative assessment'.

Use of Specific Rates	Use of Ad Valorem Rates	Use of Mixed Rates
cigarettes, fuel)		fuels and tobacco)
Singapore	Vietnam	

- Approaches to the tax base, or the basis of excise tax calculation, differed across the members' excise tax systems. As is outlined in Table 3 (alcohol beverages) and Table 4 (tobacco products) below, we see a summary of these following different approaches:
    - *Ad valorem excise systems:* taxable value was either: ex-factory selling price (or CIF + import duties for like imported goods) being the most common; however this varies across ASEAN. For example, in Thailand the calculation is for an excise and local tax inclusive ex-factory selling price (or CIF[5] + customs duty + excise duty + local tax for like imported goods); in Cambodia it is 65% of the customer's invoice price; and Myanmar it is sales receipt value;
    - *Specific rate excise systems:* taxable volume was either per litre (for liquid fuels, alcohol beverages, non-alcohol beverages) per litre of pure alcohol (LPA) (for alcohol beverages); per stick for cigarettes; or per kilogram for cigarettes and tobacco;
    - Some definitions for tobacco products (such as cigarettes) contain reference to either "per stick" (Indonesia), or "per pack" (Philippines); and
    - Some excise taxation classifications directly link the tax base to retail pricing (Philippines for alcohol).

Table 3 Basis of excise taxation of alcohol beverages in ASEAN

Litre	Litre of alcohol	Proof Litre	Ex-factory (or CIF)	Net Retail Price
Brunei	Malaysia (spirits)	Philippines	Cambodia	Philippines (spirits)
Indonesia	Singapore	Malaysia (definition only)	Laos PDR	
Malaysia (beer, & wine)	Thailand		Myanmar	
Philippines (beer, & wine)			Thailand	

[5] CIF: 'cost plus insurance plus freight'

Table 4 Basis of excise taxation of tobacco products in ASEAN

Per stick (piece)	**Per pack**	**Per kilo (or gram)**	**Ex-factory** (or CIF)	**Net Retail Price**
Brunei	Laos PDR (imports)	Brunei (cigar)	Cambodia	Indonesia (classification)
Indonesia	Philippines	Indonesia	Laos PDR	Philippines (classification)
Malaysia		Malaysia (cigar)	Myanmar	
Philippines (cigar)			Thailand	
Singapore			Vietnam	

The common "application" such as "ex-factory" does not immediately result in a universal method for determining an excise base across ASEAN. Presently, the actual meaning of this term differs between the countries where it is in use. Table 5 below provides a summary of the differing applications of the ex-factory concept:

Table 5: Definitions of "Ex-factory" used in ASEAN

Country	**"Ex-factory" definition**
Cambodia	Ex-factory sales price recorded on the invoice
Laos PDR	Sale at place of production excluding excise tax
Malaysia	Price the buyer would give for the goods on purchase in the open market at the time duty is payable but will exclude any excise duty, costs, charges, expenses of transportation and storage immediately after removal from the place of manufacture
Myanmar	Sales receipt of the producer
Thailand	Not defined (Often set by Excise Department)
Vietnam	Selling price set by producer (unless foreign trading company has >10% margin)

Finally, a lack of transparency, or immediate transparency, in identifying 'effective excise rates' can hamper adequate analysis of ASEAN excise systems. This is prevalent in areas like the taxation of fuels with a range of both subsidies in place, and the use of 'temporarily cut' excise rates and 'rate discounts' for goods meeting certain criteria. However, it is particularly difficult to readily identify the effective rates in the following instances:

Thailand and its "inclusive" excise rate, in which excise tax (and local tax) liabilities are built into either the ex-factory value for excise, or the import value, as appropriate. Furthermore, in the case of some domestically produced goods, the 'ex-factory' valuation is set by the Excise Department;

Cambodia where the excise payer can use 65 per cent of the "ex-factory sales price recorded on the invoice" rather than the actual recorded price; and

The Philippines in the case of new products, which require an estimation of "Net Retail Price" to be sworn by the taxpayer, effectively requiring knowledge of what retail prices will be applied by major supermarkets in Manila.

Excise on services will also be an important issue for ASEAN policy makers throughout the AEC process. This is despite only a limited range of services being subject to excise and in only a limited number of countries. The AEC 2015 process will impact service excises, given that the AEC Blueprint document outlines the aspiration for the "free flow" of services[6]. This is discussed in more detail below.

As with the excise taxation of goods, there are again differences to note in the approach to levying an excise on services. Table 6 below is a summary of the different tax bases applied to the various excisable services across ASEAN.

Table 6: tax bases for excisable services in ASEAN

Country	Service excise tax base
Cambodia	Invoice price of the service provided
Laos PDR	Service cost less excise tax
Myanmar	Total receipts of the supplier
Thailand	*Golf:* membership fees and green fees *Night clubs:* business turnover *Horse racing:* entrance fees and gains from racing
Vietnam	*Golf:* membership or ticket to play *Casino/gaming:* turnover less prizes paid out *Night clubs:* business turnover

[6] Paragraphs 20-22 AEC Blueprint

1.2 Moving towards AEC 2015 – a context for excise reforms

The AEC Blueprint sets the broad architecture for greater regional integration, and the context for this study. The Blueprint identifies the 2015 vision of a single market and determines to what extent the AEC will contribute towards a 'free flow' of goods and services across the region. This study seeks to help ASEAN member countries to identify how enhanced excise policy and administration can better enable ASEAN members to meet the AEC 2015 objectives.

This question is important in terms of the future movement of excisable goods across ASEAN. There are several approaches that can influence single market policy development and operation. These threshold points include:

- that *excise becomes payable at the place of domestic manufacture or the first port of import* into the ASEAN region; and
- that *excise is payable in the country of consumption irrespective of place of manufacture* or *import*. As such, some form of border tax adjustment or administration will be required over the movement of those goods to that place of consumption.

These policy issues are significant in the context of the extent of differentials in both the scope of goods and services subject to excise across the region, and the actual excise tax rates that apply from country to country.

The AEC Blueprint however, is suggesting that the "single market" and free flow of goods is nothing more than an enhanced free trade area, removing import tariffs and non-tariff barriers between ASEAN members. Furthermore, the Blueprint foreshadows a greater level of co-ordination of trade procedures and facilitation of the movement of goods between members. *These points set the context for this paper's study of the excise treatment of goods across ASEAN, and potential enhancements through the AEC 2015 process.*

There is less clarity within the AEC Blueprint regarding excisable services. There is however a reference to a "free flow of services", which could be significant for services such as telecommunications and gambling.[7] With current technological capabilities, consumers of excisable mobile phone services in one country may be able to select a mobile phone service provider from a neighbouring country that levies a lower excise, or no excise at all. Furthermore, consumers can conduct internet-based gambling on websites hosted in countries where those services are non-excisable. In such circumstances, excise policy may need to interact with other AEC policies such as licensing. Consequently, ASEAN may not see a true 'free flow' of services within the region, similar to the current situation where we are not seeing an actual 'free flow of goods' within the region.

This Discussion Paper will not focus on setting any level of harmonization of taxes on excisable goods or services. Furthermore, it will not suggest policies such as 'minimum' or 'maximum'/'capped' excise duty rates. Rather the study will focus on the desire of the AEC

[7] Telecommunications is subject to excise in Thailand, and gaming is subject to excise in Thailand and Vietnam.

Blueprint to better co-ordinate and facilitate intra-regional trade in excisable goods, and to identify and discuss possible non-tariff barriers relating to the relevant excise industries. The study also considers "best practice" excise taxation of the various goods and services, which will eventually lead to resource materials available for all ASEAN countries that can help with "benchmarking" to achieve better excise policy outcomes during future reforms.

Combining the relevant areas of the AEC Blueprint with knowledge of best practice will ensure that an effective resource is available within ASEAN to help ensure a deeper level of co-ordination of policies that impact on intra-regional trade in excisable goods and services. Importantly, this resource will be tailored to the unique characteristics of ASEAN as both a regional grouping, and a collection of independent member states with unique policy needs.

As a result, the process outlined in this Discussion Paper can be best summarised as follows:

1 To discuss a working definition or a set of working definitions that most appropriately describe the products that are intended to be subject to excise, taking note of existing definitions, definitions applied in the Harmonized System (HS) of classification, and other relevant sources;

2 In the context of best practice excise taxation policy principles and compliance with international trade rules, discuss the most appropriate tax frameworks, structures and bases to be applied to excisable goods and services;

3 For specific rates of excise duties, discuss working definitions that most appropriately describe the unit of taxation that should be applied to the goods;

4 For ad valorem excise duties, discuss working definitions that most appropriately define the tax base that the tax should be applied to the relevant good or service;

5 Establish if there is any level of connectivity as to excise taxation regionally and, if so, identify what potential impacts upon other ASEAN members' excise tax systems should be taken into account if one member undertakes any significant excise reform; and

6 Discuss a range of appropriate standards as they relate to key administrative processes that work to ensure the integrity of products and the excise revenue, including cross-border trade in excisable goods.

2. DEFINITIONAL AND SCOPING ISSUES IN APPROACHES TO PRODUCT CLASSIFICATION

2.1 Standardizing definitions of key goods subject to excise

There may be considerable benefit in attempting to offer a range of 'standard' definitions for use across the ASEAN region to describe the main excisable goods. Such an approach will need to identify possible definitions for use by Ministries of Finance in future reform processes. This has been achieved to some extent in intra-regional trade through the creation and adoption of the ASEAN Harmonized Tariff Nomenclature (AHTN), which allows for the same classification to be used for internationally traded goods in the region.

The main benefits of the AHTN are a streamlining of administration for traders, and the ability to use the same classification coding on export and import documentation. This creates certainty and consistency as traders look at determining classification (and therefore import duty considerations) in their international buying and selling. Similar benefits accrue for customs and policy administrations – which have access to easier analysis and comparison of import treatment through a standard classification of goods.

As such, a key objective of this study is to look at standardizing the definitions used for domestic excise treatment. Under such an approach, each ASEAN member state would eventually have the ability, as with imports, to have identical products classified in the same manner as other states within their excise tariff. The benefits for policy making, business investment and trade will be similar to those benefits realized under initiatives like the AHTN.

2.2 Alcohol product classification within an excise tax system

Internationally recognised classification systems such as the HS and the CODEX serve a useful purpose in terms of managing the international trade of alcohol beverages and ensuring consistency in terms of food standards. However, in terms of excise taxation, these more detailed levels of product classification for alcohol beverages create unnecessary complexity and the potential for inappropriate differential tax treatment.

International best practice for alcohol taxation follows the principle that 'alcohol is alcohol'. As outlined in Chapter 3, alcohol excise primarily addresses the 'negative externality' associated with alcohol consumption. As such, policy makers should apply alcohol excises in an equal fashion to products with similar characteristics. For example, distilled spirits products have a similar alcohol content of over 20° alcohol by volume (abv). As such, there is no sound policy rationale for individual spirits sub-categories such as whisky (HS 2208.30) and vodka (HS 2208.60) and for levying different excise rates across such sub-categories.

Several ASEAN member states already recognise this principle within their excise taxation structures. As outlined in Chapter 5.2, the following countries structure their alcohol excise rates around alcohol strength – not definition-based product sub-categories:

- *Indonesia:* has no reference to product characteristics in its excise tax structure. Indonesia simply has excise rates, set by alcohol strength irrespective of beverage type;
- *Singapore:* levies a single identical excise rate on all wine and distilled spirits beverages, with a single lower excise rate on lower-strength beer and cider beverages; and
- *Vietnam:* levies a single excise rate on all alcohol beverages with an alcohol strength above 20° abv, regardless of product characteristics.

Given the diversity of alcohol beverage products across the ASEAN region, excise structures based on alcohol strength alone would greatly simply the trade of these goods across ASEAN. Such an approach would greatly lessen the compliance burden on taxation authorities, producers and traders alike.

Table 7 identifies a simplified tiered approach for alcohol product classification, based on alcohol content. This adopts the Indonesian structure, and also (partly) takes account of the approach taken in Vietnam.

Table 7: Simplified tiered approach to alcohol product classification

Tier	Alcohol Content
Tier 3	> 20° abv
Tier 2	> 5° abv ≤ 20° abv
Tier 1	≤ 5° abv

The practical effect of this approach is that the major alcohol categories fall within the relevant tiers, as follows:

- Tier 1: beer, cider and ready-to-drink (RTD) products of similar alcohol content;
- Tier 2: wine and some liqueurs;
- Tier 3: spirits (including brandy, whisky, gin, vodka, rum etc).

There are significant simplification and administrative benefits from such a tiered approach. This approach removes any requirement for detailed technical definitions regarding what is ‘beer’, ‘wine’ or ‘spirits’. Such an approach removes any opportunities for products to be specifically developed (in terms of ingredients and/or mode of production) to manipulate definitional weaknesses or loopholes in order to obtain taxation rate advantages not intended by the designers of the excise legislation, regulations or determinations.

DISCUSSION QUESTION
WOULD ADOPTING A TIERED STRUCTURE, BASED ON ALCOHOL CONTENT, SIMPLIFY ALCOHOL TAXATION CLASSIFICATION AND ADMINISTRATION, IN YOUR COUNTRY?

2.3 Other products: the Harmonized System as a source for standard definition

One option in a search for standardization of definitions for non-alcohol products is to review the product definitions used in the Harmonized System (HS) and the AHTN (as a regional standardization of product classification for imports as discussed above).

Given the level of regional trade in excisable goods, it is considered that aligning domestic excise product definitions with imported excise product definitions (where that has not happened already) could assist in the facilitation of intra-regional trade in these goods. This approach would also be seen as 'building upon' existing standardization achieved in intra-regional trade through the AHTN.

As discussed above, this is not the preferred approach for alcohol products.

Table 8 enables further analysis of possible linkages between HS product classifications to the definition of excisable products within domestic excise law across the ASEAN member states.

Table 8: Summary of HS Headings and definitions for **excisable products** where appropriate – *World Customs Organization HS Tariff Nomenclature, 2012*

Product Category	HS Code Ref	Description	HS Notes	Study Notes	HS Item Ref	Country specific sub-category needs?
NON-ALCOHOL BEVERAGES						
Fruit and Vegetable Juices	2009	Fruit juices (including grape must) & vegetable juices, unfermented and not containing added spirit, whether or not containing added sugar or other sweetening matter	Separate items for Brix value not exceeding 20% sucrose, and for Brix value of 20% sucrose and above when measured at 20°C	Sugar content impacts classification		
Water	2201	Waters, including				

Product Category	HS Code Ref	Description	HS Notes	Study Notes	HS Item Ref	Country specific sub-category needs?
(unsweetened)		natural or artificial mineral waters and aerated waters, not containing added sugar or other sweetening matter nor flavoured				
Water (sweetened)	2202	Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavoured, and other non-alcoholic beverages,				
ALCOHOL BEVERAGES						
	HS not appropriate for alcohol beverage excise taxation purposes (see discussion above)					
NON-BEVERAGE ALCOHOL						
Distilled spirit	2207	Undenatured ethyl alcohol of an alcoholic strength by volume of 80% or higher; ethyl alcohol and other spirits.	Alcoholic strength by volume shall be determined at a temperature of 20 °C May be blended with petroleum or other denaturants for use as fuel	Undenatured Denatured (or rendered unfit for human consumption)	2207.1 2207.2	
TOBACCO						
Unmanufactured tobacco	2401	Unmanufactured tobacco and		Not stemmed or stripped	2401.1	

Product Category	HS Code Ref	Description	HS Notes	Study Notes	HS Item Ref	Country specific sub-category needs?
		tobacco refuse		Partly stemmed or stripped Refuse Excludes uncured tobacco	2401.2 2401.3	
Manufactured tobacco	2402	Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes		Cigars, cheroots, and cigarillos containing tobacco Cigarettes containing tobacco Other	2402.1 2402.2 2402.9	Indonesia & Philippines categorize by machine versus handmade, and by retail price
Other manufactured tobacco	2403	Other manufactured tobacco and manufactured tobacco substitutes; "homogenized" or "reconstituted" tobacco; tobacco extracts and essences		Smoking tobacco, whether or not containing tobacco substitutes in any proportion Other	2403.1 2403.9	Kreteks, biddies?
HYDRO-CARBON FUELS						
Aromatics	2707	Oils and other products of the distillation of high temperature coal tar; similar products in which the weight of the aromatic constituents exceeds that of the non-aromatic	Need to contain more than 50% benzene, toluene, xylenes as appropriate	Benzol (Benzene) Toloul (Toluene) Xylol (xylenes) Naphthalene Other	2707.1 2707.2 2707.3 2707.4 2707.5	

Product Category	HS Code Ref	Description	HS Notes	Study Notes	HS Item Ref	Country specific sub-category needs?
		constituents				
Petroleum oils and oils obtained from bituminous minerals, crude.	2709					
Petroleum oils and oils obtained from bituminous minerals, other than crude	2710	Petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70 % or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations		Light oils Waste oils	2710.1 2710.9	
Petroleum gases	2711	Petroleum gases and other gaseous hydrocarbons		Liquid form: -LNG -Propane -Butane -Ethylene, butylene propylene, and butadiene - Other Gas form: -Natural gas -Other	2711.1 1 2 3 4 9 2711.2 1 9	
Residues	2713	Residue of petroleum oils obtained from bituminous minerals				

Product Category	HS Code Ref	Description	HS Notes	Study Notes	HS Item Ref	Country specific sub-category needs?
MOTOR VEHICLES						
Motor vehicles for the transport of ten or more persons, including the driver	8702		By number of seats			Vietnam 16-24 seat category
Motor cars and other motor vehicles principally designed for the transport of persons (less than 10), including station wagons and racing cars.	8703	Vehicles with spark-ignition internal combustion reciprocating piston engine Other vehicles, with compression-ignition internal combustion piston engine (diesel or semi-diesel): Special vehicles eg golf carts	Includes: 1. Pickup Passenger Vehicles (PPV) - single cab - dual cab 2. Eco Car - engine size -fuel efficiency - emissions 3. Alternate fuel car - electric and fuel cells - ethanol - hybrids	-<1,000 cc -1,000-1,500 cc -1,500-3,000 cc ->3,000 cc -<1,500 cc -1,500-2,500 cc ->2,500 cc	8703.21 8703.22 8703.23 8703.24 8703.31 8703.32 8703.33 8703.1	
Parts and accessories for motor vehicles	8708					
Motorcycles (including mopeds) and cycles fitted with an auxiliary motor, with or without side - cars	8711	Motor cycles and mopeds (with or without side cars)		With reciprocating internal combustion piston engine of a cylinder capacity: - up to 50cc - >50cc – 250cc ->250cc – 500cc ->500cc – 800cc	8711.1 1 2 3 4	

Product Category	HS Code Ref	Description	HS Notes	Study Notes	HS Item Ref	Country specific sub-category needs?
				->800cc Side cars	5 8711.9	

2.4 Other sources for standard definitions

The HS system of classification has advantages in its universal usage in international trade by World Customs Organization (WCO) member countries. This framework ('nomenclature') allows for a large degree of consistency in definitional issues for importers and exporters as they classify goods for duty and tax purposes. However, this study also looks at other international conventions or treaties that have compiled 'standard' definitions for global use.

This study reviews three such conventions that focus on the main goods subject to excise across ASEAN. These international conventions include:

- The World Health Organization (WHO) Protocol to Eliminate the Illicit Trade in Tobacco Products for tobacco;
- the CODEX International Food Standards for alcohol and non-alcohol beverages; and
- the United Nations Economics Commission for Europe's "Classification and Definition of Motor Vehicles".

2.4.1 Tobacco products

The WHO Protocol to Eliminate the Illicit Trade in Tobacco was adopted by the Parties to the WHO Framework Convention on Tobacco Control (WHO FCTC) in November 2012. This international treaty is aimed at combating illegal trade in tobacco products through control of the supply chain and international cooperation.[8]

In terms of tobacco products, the WHO Protocol to Eliminate the Illicit Trade in Tobacco Products has certain definitions which are worth highlighting in this section of the paper. Here both cigarettes and tobacco products have been defined as:

- "Cigarette" means a roll of cut tobacco for smoking, enclosed in cigarette paper. This excludes specific regional products such as bidis, ang hoon, or other similar products which can be wrapped in paper or leaves. For the purpose of Article 8, "cigarette" also includes fine cut "roll your own" tobacco for the purposes of making a cigarette.[9]

[8] WHO Protocol to Eliminate Illicit Trade in Tobacco Products ('the Protocol'), WHO, http://www.who.int/mediacentre/news/releases/2013/fctc_20130110/en/, sources 4 July 2013
[9] Paragraph 2 Article 1 of the Protocol

- "Tobacco products" means products entirely or partly made of the leaf tobacco as raw material, which are manufactured to be used for smoking, sucking, chewing or snuffing.[10]

The main difference to the definitions used in the Protocol to those of the HS classifications appears to be that "roll your own" tobacco is classified as a "cigarette". This would be an important discussion point for several ASEAN countries, which have lower excise rates for "roll your own" than apply to cigarettes.

2.4.2 Non-alcohol beverages – food standards classification

The United Nations (UN), through its key bodies the WHO and the Food and Agriculture Organization of the United Nations (FAO) established the Codex Alimentarius Commission in 1963. This Commission has responsibility for the development of a universal set of harmonised food standards, guidelines and codes of practice. A key objective of the Commission is to protect the health of consumers and ensure fair practices in the food trade.[11]

The Codex International Food Standards ('CODEX') provides a further internationally recognised and observed nomenclature, which provides a degree of standard classifications for food and beverage products. In many countries around the world, the CODEX forms the basis upon which authorities develop and implement food and beverage regulations. Through the use of standard classifications and standards, regulators can effectively monitor food and beverage products that enter their market. This enables governments to adequately account for goods within the market in terms of health, safety and (where required) product recalls.

The CODEX contains a listing of food categories and assists in terms of highlighting the main categories of beverages. These classifications include excisable beverage products, including non-alcohol beverages, which are levied with an excise across the ASEAN region. The CODEX provides a simplistic starting point for perhaps establishing what categories could be subject to excise, or which require more specific definitions. It would appear that in many cases these beverages need no further definition. The CODEX listings have been reproduced in Table 9.[12]

Table 9: CODEX Food Standards – beverages

	Number
	14.0
Non-alcoholic ("soft") beverages	14.1
Waters	14.1.1
Natural mineral waters and source waters	14.1.1.1
Table waters and soda waters	14.1.1.2
Fruit and vegetable juices	14.1.2
Fruit juice	14.1.2.1

[10] Paragraph 13 Article 1 of the Protocol
[11] Codex Alimentarius Commission, www.codexalimentarius.org, sourced 4 July 2013
[12] See http://www.codexalimentarius.org/codex-home/en/

Vegetable juice	14.1.2.2
Concentrates for fruit juice	14.1.2.3
Concentrates for vegetable juice	14.1.2.4
Fruit and vegetable nectars	14.1.3
Fruit nectar	14.1.3.1
Vegetable nectar	14.1.3.2
Concentrates for fruit nectar	14.1.3.3
Concentrates for vegetable nectar	14.1.3.4
Water-based flavoured drinks, including "sport," "energy," drinks	14.1.4
Carbonated water-based flavoured drinks	14.1.4.1
Non-carbonated water-based flavoured drinks, including punches	14.1.4.2
Concentrates (liquid or solid) for water-based flavoured drinks	14.1.4.3
Coffee, coffee substitutes, tea, herbal infusions, and others	14.1.5
Alcoholic beverages, including alcohol-free and low-alcoholic counterparts	14.2
Beer and malt beverages	14.2.1
Cider and perry	14.2.2
Grape wines	14.2.3
Still grape wine	14.2.3.1
Sparkling and semi-sparkling grape wines	14.2.3.2
Fortified grape wine, grape liquor wine, and sweet grape wine	14.2.3.3
Wines (other than grape)	14.2.4
Mead	14.2.5
Distilled spirituous beverages containing more than 15% alcohol	14.2.6
Aromatized alcoholic beverages (e.g., beer, wine and spirituous coolers)	14.2.7

The CODEX is a complex product classification framework. In the case of alcohol beverages, excessive product categories enable the development and application of different excise rates to similar products at the subcategory level. This is in contrast to international best-practice as outlined earlier in Table 7.

Whilst the CODEX provides a comprehensive approach for maintaining product and safety standards, it does not constitute an appropriate structure for alcohol excise.

2.4.3 Motor Vehicles

Finally, certain useful definitions were extracted from the United Nations Economics Commission for Europe's (UNECE) "Classification and Definition of Motor Vehicles". On review, the definition at the 'high level' were useful, however the ASEAN region

has a focus on engines size in classification and rate differentials and a look at the 'lower level' product classifications seemed of limited use.

However, as for definitions of motor vehicle and motor cycles as starting items, the document includes the following:[13]

1.2. "*Motor vehicle*" means any power-driven vehicle which is normally used for carrying persons or goods by road or for drawing, on the road, vehicles used for the carriage of persons or goods. This term embraces trolley-buses, that is to say, vehicles connected to an electric conductor and not rail-borne. It does not cover vehicles such as agricultural tractors, which are only incidentally used for carrying persons or goods by road or for drawing, on the road, vehicles used for the carriage of persons or goods.

1.3. "*Motor cycle*" means any two-wheeled vehicle, with or without side-car, which is equipped with a propelling engine. Contracting Parties may also treat as motor cycles in their domestic legislation three-wheeled vehicles whose unladen mass does not exceed 400 kg. The term "motor cycle" does not include mopeds, although Contracting Parties may treat mopeds as motor cycles for the purpose of the Convention.

2.4.4 Summary of possible definitional approaches

Table 10 captures key product classification and definitional characteristics following a review of each of the HS tariff, the Protocol on Illicit Trade of Tobacco, the CODEX and the UNECE. This table is an initial attempt at developing a 'summary of definitions' template for further analysis.

It is envisaged that this template could serve as a potential 'item format' for setting out future standard definitions.

Table 10: Summary capture of definitions from relevant sources

Item	Item Definition	Sub-Item	Definition
Alcohol beverages	Beverages containing alcohol	≤ 5° a.b.v.	All potable alcohol beverages (fit for human consumption), regardless of product characteristic or HS classification for customs purposes.
		>5° a.b.v. ≤ 20° a.b.v.	
		> 20° a.b.v.	
Non-alcohol beverages	Beverages not containing alcohol	Waters	Including natural mineral water and soda water
		Fruit & Vegetable Juices	
		Fruit & Vegetable Nectars	
		Water based flavoured	

[13] http://www.unece.org/trans/main/wp29/wp29wgs/wp29gen/wp29classification.html

Item	Item Definition	Sub-Item	Definition
		Infused beverages	
Non beverage alcohol	Concentrated distilled spirits	Un-denatured	Linked to excise rate for alcohol beverages > 20° a.b.v.
		Denatured (non-potable)	
Tobacco		Un-manufactured	
		Tobacco Products	Means products entirely or partly made of the leaf tobacco as raw material, which are manufactured to be used for smoking, sucking, chewing or snuffing
		Cigarettes	A roll of cut tobacco for smoking, enclosed in cigarette paper, excluding specific regional products or other similar products which can be wrapped in paper or leaves. "Cigarette" also includes fine cut "roll your own" tobacco for the purposes of making a cigarette
Motor Vehicles	Means any power-driven vehicle which is normally used for carrying persons or goods by road or for drawing, on the road, vehicles used for the carriage of persons or goods	Motor vehicles for the transport of ten or more persons, including the driver	
		Motor cars and other motor vehicles principally designed for the transport of persons (less than 10), including station wagons and racing cars.	
		Parts and accessories for motor vehicles	
Motor Cycles	Means any two-wheeled vehicle, with or without side-car, which is equipped with a propelling engine. Contracting Parties may also treat as motor cycles in their domestic legislation three-wheeled vehicles whose unladen mass does not exceed 400 kg.	Motorcycles (including mopeds) and cycles fitted with an auxiliary motor, with or without side -cars	

DISCUSSION QUESTION
BASED ON ALL RELEVANT SOURCES AND BEST PRACTICE, DOES TABLE 10 REPRESENT A SIMPLIFIED APPROACH TO CATEGORISING AND DEFINING KEY EXCISE GOODS?

3. DEFINITIONAL ISSUES RELATING TO SETTING THE TAX BASE

3.1 Specific rate taxation

Taxation by volume or quantity is known as 'specific taxation', which is levied according to the physical characteristic of the product. In the case of excise taxation, specific rates can be levied in several ways, for example rates based on a 'per kilogram' or 'per litre' basis. Specific taxation is most relevant to the question of addressing the externalities of certain products such as alcohol beverages, tobacco products, petroleum products, and CO_2 emissions.

Specific rate taxation is also seen as being a more equitable basis on which to tax these types of goods, as it directly addresses the 'harm' element which exists irrespective of the cost of production. Specific taxes are considered to be world's best practice for excise taxation policy, as the excise rate accurately sets a price signal that is solely determined by the negative externality that the tax is designed to address. As such the excise calculation should not take into consideration other factors such as product origin, product sub-classification based on raw materials or the ex-factory or CIF value of a product.

Specific tax rates also lead to more stable revenue streams that will grow in line with consumption. Unlike value-based excises, specific taxes are always linked to consumption and are not hostage to fluctuations in economic conditions such as downturns, price increases etc. Each of these fluctuations can work to shift consumption to lower cost products, reducing revenue collected by government but not reducing overall consumption. This creates a divergence between actual consumption patterns and the health and social policy intent of the excise.

Specific taxes also have the administrative advantage of not being able to be undermined by manipulations of values or under-invoicing, a practice more easily achieved when using value-based excise taxes. Manipulations of the values for excise taxation in these situations are often 'legitimate', resulting from normal commercial arrangements such as bulk purchase discounts, advanced payment discounts, or transfer pricing agreements.

In terms of 'day-to-day' administration, specific taxation is also generally simpler in terms of compliance and control. Specific excises are related to the measurement of physical product, which can be verified as it passes flow meters, counters, scanners, or is placed into packets and boxes. Some excisable goods can be volatile in nature, which can impact on the ease of administration. However, this paper will address this issue below by way of discussing *standardizing taxable volumes and correction factors* where applicable.

Finally, specific rates of excise do run the risk of 'falling' in real terms over time as fixed rates are not pegged to inflation in the economy. As such, they do need to be adjusted regularly, for example annually, in line with the prevailing inflation rate.[14]

[14] Australia for example increases its excise rates for alcohol and tobacco twice yearly in line with its consumer price index (CPI).

3.2 Ad valorem taxation

Excise taxes can also be levied on the value of a product. Taxation by value is known as 'ad valorem' taxation and the value used for excise assessment (the 'tax base') will be at a designated point in the supply chain, such as the ex-factory selling price, wholesale price and in some cases the retail selling price. In terms of imports however, the common valuation is the importer's Cost plus Insurance plus Freight (CIF) value, as set out in customs valuation law plus any import duties payable. Together these two components of a good's value are often referred to as the "landed price".

One benefit of ad valorem excises is that they maintain their value in real terms, as adjustments to the tax base value recognize inflationary increases to raw materials and other costs. Other arguments in support of ad valorem taxation include ensuring a level of affordability in some products for those living on minimum incomes.

However, ad valorem taxes do not create certainty for governments who are often subject to fluctuations in revenue collections. A change in economic conditions, tax rates and prices can lead to what is known as "trading down", in which consumers simply switch consumption to lower priced (and therefore lower taxed) products. Manufacturers may also adjust to market conditions such as tax burden increases by instituting practices such as cost cutting, price re-structuring and absorbing tax increases through smaller margins. All of these practices can reduce both excisable value and excise collected.

Furthermore, ad valorem taxation does lend itself to tax planning opportunities by producers or importers to lessen their tax burden. These include removing cost components from excisable values or transferring costs and profits past the taxing point to reduce the excisable value and excise payable. "Domestic transfer pricing" as some countries called it is a risk, or perhaps a fundamental flaw, with value based excise taxes.

'Luxury' taxes

However, it is recognised that the nature of some goods (and of course services), means that ad valorem excises may continue to be used on a temporary basis. Ideally, where taxation of luxury items is the sole driver of the tax policy (such as we see for precious stones, jewellery items, perfumes and carpets (in some ASEAN countries)), these taxes should eventually be removed, to allow the generally applying Goods and Services Tax (GST) or the Value Added Tax (VAT) to be the means of collecting taxation revenue on high value 'luxury' items. GST and VAT is levied on an ad valorem basis. Excise taxes on luxury goods should only be seen as a temporary approach, pending transition into overall coverage by the relevant VAT or GST. The removal of the Luxury Sales Tax (LST) on alcohol products in Indonesia in 2010 is an example of a reform in the right direction.

Where a combination of luxury and externalities is driving the tax policy, such as with motor vehicles – then ad valorem remains an appropriate tax base.

These luxury circumstances differ from excises designed for 'externality correcting' purposes, such as excises on alcohol beverages, fuel and tobacco. As outlined above, linking the excise price signal to product value does not help policy makers to achieve health and social policy objectives associated with risky or harmful consumption. That is why ad valorem taxation is not generally suited to excise systems.

3.3 Standardizing the Taxable Unit / Value in the Tax Base

Apart from the potential benefits in establishing a range of 'standard' definitions which relate to goods, the next step is to look at providing a similar standardization of the tax base – both in terms of units of taxation and definition as they relate to the tax base.

Once agreed, these recommended standards can be incorporated with the standardized definitions for the purposes of creating a 'benchmark' excise tax approach to the structure of the good or service to be taxed. Excisable products are ideal for such a standardization process, given that excises across ASEAN apply to a narrow base of goods and services.

The benefit at this point is not just in terms of aspiring to consistency in definition across the region, but also in terms of the specific rate taxation of volatile goods such as alcohol and fuels (and to a lesser extent tobacco). The outcomes of this project could enhance administration of these goods across ASEAN.

3.3.1 Standardizing specific rate taxation

"Alcohol Beverages"

Where alcohol beverages are to be taxed on a specific excise basis, two options exist:

- an excise rate based on the volume of liquid in the product (for example litres of beer, wine or distilled spirits); or
- an excise rate based on the alcohol content within the product (for example LPA within the beer, wine or distilled spirits).

The EU for example has directed member states to use a specific taxation approach to the taxation of alcohol products.[15]

'Per litre' approach

A leading example of the first option is Indonesia, where alcohol is subject to taxation on a 'per litre' basis. This approach was confirmed in the reforms of 2010, where the 'per litre' approach applied to all categories of alcohol product. Other countries which apply the 'per litre' approach include Malaysia (some alcohol categories).

[15] See Articles 3, 9 and 21 (beer, wine and spirits respectively) of EU Directive 92/83/EEC of 19 October 1992

The first option, whilst being the simplest, does not truly reflect the 'externalities' associated with the consumption of alcohol. Further, a 'per litre of product' rate can incentivise the un-intended result of favouring cheap high strength products. For example, two beers of differing alcohol strengths are paying the same excise taxes and therefore likely to have little or no price differential at the consumer level. Indeed if the higher strength beer is cheaper to produce it could in fact result in a lower retail price than the lower strength beer. This is not a desirable outcome from a social policy and health perspective.

'Per litre of alcohol' (LPA) approach

The second option of 'per litre of pure alcohol' (LPA) best reflects the externalities associated with alcohol consumption in that the excise is levied upon the actual alcohol content. As such, the excise tax (and price to consumer) will rise in line with the alcohol strength of the beverage. In short, the more alcohol consumed – the more excise tax is paid. The WHO has recommended specific taxation of alcohol based on alcohol content to use price as part of a strategy to curb harmful levels of consumption, as highlighted in the extract from the strategy below:[16]

> *"(a) establishing a system for specific domestic taxation on alcohol accompanied by an effective enforcement system, which may take into account, as appropriate, the alcoholic content of the beverage"*

Consistent with the WHO recommendation, increasing numbers of ASEAN countries, and several neighbouring countries with which ASEAN has free trade agreements, utilise the per LPA method of alcohol excise taxation. These include Singapore, Philippines (per Proof Litre), Malaysia (some categories), Thailand ('greater of' approach), Australia, and New Zealand.

As taxation based on LPA becomes more prevalent across the region, producers, importers and excise authorities are developing more efficient methods of establishing the alcohol content of the beverage. These initiatives are complementary to the changes taking place in most jurisdictions, which are requiring manufacturers (and importers) to prescribe alcohol strength on the product's label. The monitoring of the actual alcohol strength against the label strength is subject to consumer laws, which tax authorities can readily leverage for their administrative and compliance purposes. Many administrative solutions have been developed for issues that arise during production and accounting for production, transfers of bulk product (including internationally) and in the bottling/packaging bulk product.

In these cases it is important for excise licensees and tax authorities to have the ability to track the excise liability of the alcohol contained in each of the products. In this regard, licensees and authorities need to be able to establish the LPA in such products at any point in time by establishing standards to confirm actual quantities. Given the volatile nature of alcohol, this is achieved by measuring both the alcohol strength of the product via hydrometer or similar device, and the temperature of the product. Comprehensive procedures should ensure a 'standard temperature' at which to measure the alcohol content. Within the correct climatic conditions, a set of alcohol tables

[16] World Health Organisation (2010) Global Strategy to Reduce Harmful use of Alcohol page 16

is used to determine the correct alcohol strength. These procedures are well established and have been simplified for implementation in many locations in the broader region.

The most common standard temperature for determining alcohol strength is 20 Degrees Celsius (20°C), which is articulated within the relevant Chapter notes for alcohol beverages in the HS.[17] The main exception is the United States, which corrects alcohol temperature to 60 Degrees Fahrenheit (or about 15.6 Degrees Celsius).[18] *Given the study's work with the HS, it would seem logical to support continued use of a standard 20 Degrees Celsius temperature to determine alcohol strength.*

It is also noted that some countries also use alcohol strength for excise rate classification purposes (see Indonesia and the Philippines). *This prescribed use of alcohol strength within the excise tax system should also set strength corrected to the same standard temperature of 20 Degrees Celsius.*

(NB: Temperature correction for volumes should also be applied to non-beverage alcohol, including alcohol to be used for industrial use tax-paid, industrial use tax-free and / or as fuel ethanol).

"Petroleum Fuels"

Like alcohol, petroleum fuels are also volatile in nature and volume changes will occur when there are changes to air temperatures. As such the use specific rates of excise will require some form of standardization. The main administrative issues again arise during production and accounting for production, transfers of bulk product (including internationally) and in pumping into trucks, drums and tanks for sale.

In these cases it is important for excise licensees and tax authorities to be able to track the excise liability of the fuel from production to the taxing point. In this regard, licensees and authorities need to be able to establish the volume of such fuels at any point in time up to excise tax payment by establishing standards to confirm actual quantities. This is achieved by measuring both physical quantity, and the temperature of the product. Then there is a 'standard temperature' for use in converting the actual volume to a corrected volume.

The most common standard temperature for determining petroleum fuel volumes is 15 Degrees Celsius, although the US similarly to alcohol seems to correct to 15.6 Degrees Celsius.[19] The Chapter notes of HS Chapter 27 are silent on temperature correction for volume, and so it is seen as more appropriate to consider the more widely used temperature correction to 15 Degrees Celsius.

Tobacco Products

Tobacco products subject to specific rates are generally taxed: per stick / 1000 sticks; per pack; per gram or per kilogram. Taxation per weight (gram or kilogram) needs no real further discussion as to

[17] Chapter notes Chapter 22
[18] CFR Chapter 27 Distilled Spirits
[19] To be confirmed in CFR's

standardization other than probably to align the rate per weight with a rate per stick or per pack where both approaches appear in the excise tariff. Without some alignment the risk is that manufacturing and consumption will shift to the lowest effective tax rate in the system.

Taxation on a quantity base may require further consideration in the context of setting standards as without clear definitions, the potential for loopholes exists.

Tobacco stick (cigarette)

It is common for countries to define a 'stick' in terms of the weight of the tobacco contained in the stick. Without such a definition, cigarettes could become 'super size' without additional excise payable. Thus a standard definition or at least a standard weight for a 'stick' should be considered.

In this regard Singapore sets the maximum weight of a stick at one gram (tobacco + filter), with the per gram rate equivalent to the per kilogram rate used for other tobacco products (i.e. $0.352 per gram per stick versus $352.00 per kilogram for other tobacco products). Australia has defined a 'stick' as containing a maximum of 0.8 grams of tobacco.[20] Where a stick exceeds this weight its classification changes from a cigarette to "other tobacco products" and pays a per kilogram excise rate which corresponds with the per stick rate based on a stick being 0.8 grams. A similar definition of cigarettes is used in New Zealand, whereas countries like Brazil and India also include an element of a filter (or not) and stick length.[21]

Cigarette Pack

Specific tax rates based on 'per pack' also requires a 'pack' to be defined both in terms of the stick (see above) and the number of sticks that will comprise a pack.

The Philippines currently uses "not more than 20" sticks as being a "pack".[22]

3.3.2 Standardizing ad valorem taxation

Value based tax bases require the identification of a point in the distribution chain from manufacture to retail at which to assess a value of the goods or service. This is sometimes also known as the 'taxing point'. However, in some cases it has been found that the taxing point may be when goods leave a licensed production factory, but the value used for excise purposes could be further along the supply chain at a 'wholesale price' or 'retail price' level. Following is a discussion on the range of valuations used for excise purposes.

[20] Item 5.1 of the Excise Tariff Act 1921
[21] Sunley E (2009) Taxation of Cigarettes in Bloomberg Initiative Countries: Overview of Policy Issues and Proposals for Reform, World Bank
[22] Section 145 Republic Act 10351, 2012

Ex-factory

The most commonly used valuation base for domestically produced products within ASEAN is 'ex-factory'. Whilst this is a common term in excise tax systems across the region, the term is defined differently in each country which uses it. All ASEAN countries using ex-factory as the tax base seem to have raised concerns about its application, with one area of concerns being that some producers establish a distribution network that allows them to 'shift' certain production costs to a non-arm's length distribution entity, which thereby lowers the excisable ex-factory value. Notwithstanding, many companies normally structure their businesses in this way as 'good business' practice to lower their costs associated with doing business in the region.

As seen in Table 5, in most cases, 'ex-factory' values are linked to the producer's invoice selling price to the customer. However, Vietnam, the Philippines, and Malaysia have gone further and have attempted to address the price shifting issue by way of looking at the value of the subsequent sale for profit shifting (Vietnam and the Philippines)[23] and through linking the sale to the 'open market' (Malaysia).

Whichever definition is utilized, the issue of price shifting will remain and will be difficult for excise authorities to administer. For products suited to specific taxation, a transition from ad valorem taxation to specific rate taxation, should form part of considerations of any future reforms of excise given that with *the introduction of a specific structure all issues relating to valuation – including, but not limited to, price shifting, can be overcome*

In case of ad valorem taxes with the ex-factory as base, definitions should be tied to actual valuations of sales at the producer level. However, arrangements are required for non-arm's length transactions. Here, significant work could be done to look at existing customs and tax legislative provisions to see how the question of import valuation is dealt with when importations are non-arm's length. These procedures include 'transfer pricing agreements' or 'advanced pricing agreements', in which producers and relevant tax authorities can agree on appropriate and realistic import valuations where the importation is from a related entity. A similar approach can be explored, to apply in circumstances where the domestic manufacturer is selling to a related party. This type of arrangement may also provide certainty to industry and a level of assurance for revenue agencies.

DISCUSSION QUESTION
CAN ADVANCED PRICING AGREEMENT PROCESSES BE DEVELOPED TO SUPPORT EX-FACTORY VALUATIONS?

[23]The Philippines refers to a "gross selling price" for certain goods. Both Vietnam and the Philippines have a 'trigger' when margins of subsequent sales are greater than 10%

Ex-factory is essentially a cost-base valuation that applies to domestic production at a point where the product enters the market. The equivalent base for imported products is the landed-cost, i.e. the CIF + import duty, the key element of which is the import valuation.

Imports

The key principle in relation to imports valuation is the 'National Treatment' principle, which provides that the valuation rules or process should not act to discriminate against imported goods, following Article III of the General Agreement on Tariffs & Trade (GATT), see below paragraphs 1 and 2 respectively:

> *"1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.*
>
> *2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1."*[24]

Therefore, where there are internal taxes such as excise, and internal regulations such as an excise valuation process, these taxes and regulations cannot be applied to imports in excess of those applying to like domestic goods, nor be applied to imports so as to afford protection to the domestic 'like good'.

In general, imports are valued for excise purposes using Customs valuation law and principles. Customs valuation is the transaction value or price paid or payable at the CIF level, plus any import duties payable. This valuation is an attempt to find a common point in the supply chain to domestic goods leaving a factory or warehouse, such as delivery into the commerce of the local market.

The main exception to this is Thailand where an 'inclusive value' is used to determine the tax base for assessing ad valorem excise duties, as it is with domestic production. Inclusive valuation means that the taxable base value for calculating excise on domestic (ex factory) or imported products also includes the excise and local tax payable. For imports this means the excise tax base (E) calculation becomes:

- E = CIF + import duty + excise duty + municipal tax.

[24] *General Agreement on Tariffs and Trade (GATT) 1994*, and appendix to the W*orld Trade Organization (WTO) Agreement 1994*

It is suggested that for a cost base approach, excisable value for imports continue to be CIF plus import duty. The taxing point should apply as early in the supply chain as possible and utilise the value of the good at that particular point in the supply chain; the value relevant to the producer or the importer. Applying a tax base that is calculated at a later point in the supply chain creates numerous challenges. Unless sophisticated systems are in place to accurately track the movement of an excise liability, ad valorem tax bases calculated at the wholesale or retail price level are open to price manipulation, such as 'under-invoicing'.

Retail Price

The main issue perceived with retail pricing as a tax base is not with definition but with administration. In theory, a producer (or importer) needs to have knowledge of retail pricing despite the retail price, under certain circumstances, being set by a completely unrelated entity, which occurs several points down the supply chain. Whilst Net Retail Pricing for classification purposes is published in the Philippines, this requires a significant devotion of resources to keep this publication up to date for tax payers.

Utilisation of the 'retail price' or a 'wholesale price' as an ad valorem tax base is problematic if effective systems are not in place to manage excise liabilities incurred at a retail level. International best practice demonstrates that excise taxes should only be levied once within the supply chain. The system should not result in computing a value at another point in the supply chain unless there is also a shift in the taxing point. This could not occur without an administrative system in place to manage a shift, or transfer, of the taxation liability. Examples in other countries include systems of 'quoting' and 'bonded warehouses', which enable an authorized shift of the excise liability from the producer or importer to the last wholesaler. *These issues are covered in greater detail in Chapter 4.*

4. PRINCIPLES OF GOOD EXCISE ADMINISTRATION

Excise taxation systems differ across the ASEAN member states in terms of the goods and services subject to excise, the manner of taxation, the rates of excise and the taxing point. However, the basic objectives of each excise system should be the same from an administrative perspective. In particular, an effective excise system will ensure proper account and payment of all excise duties due by the due date.

To begin examining the relationship between these objectives and the key areas of administration, it is helpful to look at an excise tax system as containing three critical areas to manage:

- excise liability creation;
- excise liability on hand; and
- excise liability acquittal.

Figure 1 'Tracking excise liabilities' is a diagrammatical representation of these three components and their relationship through the supply chain.

Figure 1: The main areas of an excise tax system to manage

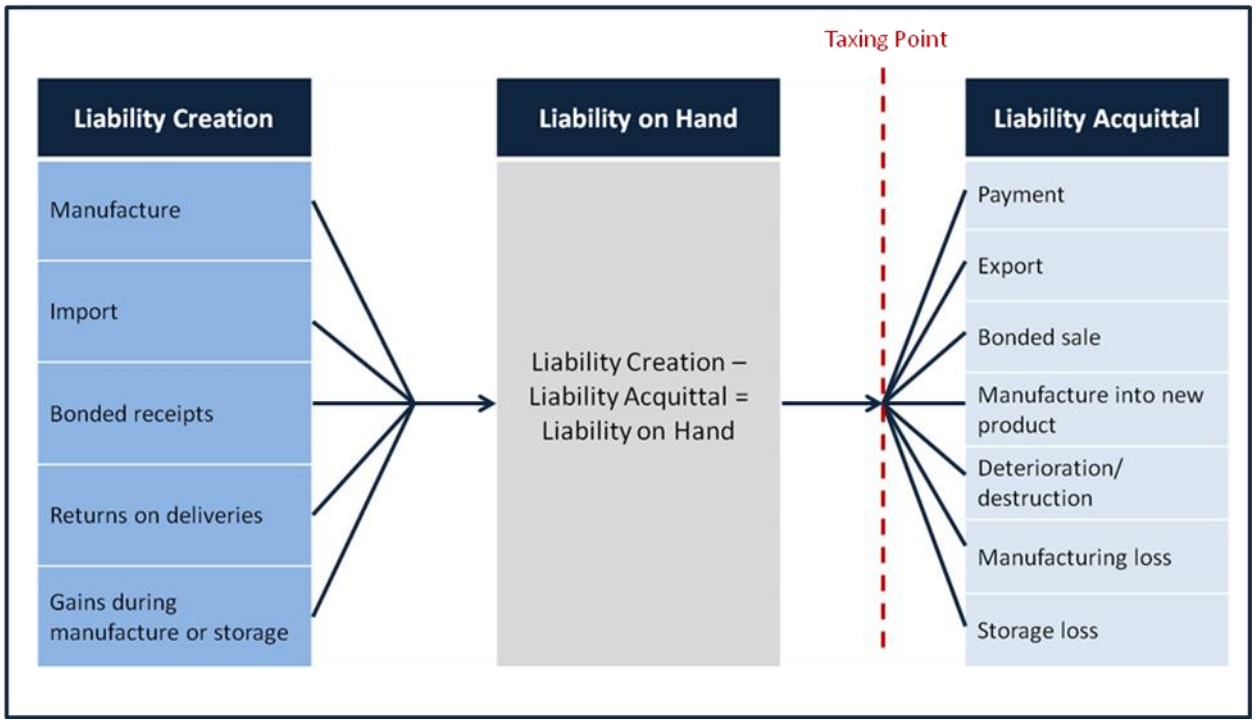


Figure 1 breaks down the excise taxation system into the three components identified. The first component comprises the creation of excise liabilities.
An entity with the excise system can create an excise liability in one of several ways, including:

- domestic manufacture or production of goods which are subject to excise. The situation however, may be somewhat different for services, in which case the liability may not actually be created until the service is performed;
- import of 'like' goods which are subject to excise;
- receipt of excisable goods from other bonded entities in which the excise liability has been transferred from that other entity;
- returns of goods from the market place for which the entity has paid excise or is liable to pay excise but for which that excise or excise liability can be credited or refunded and the goods placed back into a bonded status; and
- gains in product volumes during either the manufacturing or storage operation.

Upon the creation of an excise liability, the entity holding that liability needs to be able to either properly acquit the liability or be able to account for that liability in the form of stock on hand or expected losses. Acquittal of excise liability can occur in many different ways, but primarily it is via the good or service passing through the 'taxing point' and appropriate excise duties being remitted by the licensee.

The taxing point can be described as the 'trigger', or the point at which the legislation provides for the liability over the excisable goods or services to be recognised and brought to account for the purposes of payment of the appropriate duty. Whilst excise duty may not be reported and paid at the time the goods pass the taxing point, such as in systems that offer deferred or periodic settlement of duty, passing the taxing point will serve to confirm the following factors:

- the rate of excise in force for the calculation of the duty;
- the accounting period for which the excise duty liability must be reported;
- the due date for reporting the liability; and
- the due date for excise duty payment.

Taxing points vary from excise system to excise system with alignment to domestic perceptions of excise. If excise is viewed locally as a 'production tax' or 'manufacturing tax', then the taxing point will be closer to the place of manufacture. Such examples include, delivery from the production area into storage, delivery from licensed excise manufacturer's premises, or collected with any import duty at the time of importation. Alternatively, if excise is viewed more as 'consumption tax', then the taxing point is more likely to be at a point where the good or service enters the market for retail sale, perhaps at the end of a long supply chain.

Dependent upon local excise laws and administrative arrangements, excise liabilities may also be acquitted in several other ways. The nature of manufacture often gives rise to loss or waste of materials during production and it is common to find systems in which otherwise excisable goods can be 'written off' if they are lost, destroyed or laid to waste as part of the production process and will not be entering the domestic market for sale or consumption.

Similarly, the storage of excisable goods can also see damage, destruction and other forms of deterioration which result in those goods being sent on commercial grounds for some form of destruction or recycling processes, rather than being delivered into the market. In addition, the nature of some excisable goods will see other forms of production and storage losses such as evaporation, spillages, and pipe and tank dregs that are generally seen in volatile liquids like petroleum fuels and alcohol.

The notable aspect of such losses is that the excisable goods involved will not be delivered into the domestic market and as such may give rise to an acquittal of the excise liability which had attached to the goods upon their production or importation.

A final area of excise liability acquittal comes from other sales or transfers of excisable goods and services which acquit the liability by way of those goods meeting some prescribed conditions over their end-use or destination. In terms of end-use, certain prescribed end-uses may give rise to an acquittal of excise liability including use of a raw material input in the production of a non-excisable good, or the use of the product in a manner that the government does not intend to be excisable.

Perhaps the best example of these circumstances arises for distilled spirits, in which consumption as a beverage is to be subject to excise, however, distilled spirits as a raw material input to the manufacture of commercial goods such as paint, lacquers, dyes and aerosols, should not be subject to excise in the same manner. Alternatively, there may be an excise on motor vehicles for general domestic use. However, certain vehicles intended for certain commercial or community purposes such as ambulances, fire-fighting trucks, or police vehicles may be exempt from excise. In such circumstances, acquittal of the excise liability occurs, upon fulfilling the specifications of such a delivery.

Sales of excisable goods and services may also be exported to off-shore markets in which case, in the absence of any export duties, excise duties are not generally payable, are 'zero rated' or 'exempted'. The basic principle which is followed in many excise systems is that if the good or service is not to be consumed in the domestic market, then there will be no excise payable. The confirmation of export status in such cases will acquit any liability. Sales of excisable goods may also be made to other entities that deal in excisable goods and have the necessary licensing and approvals to receive excisable products from manufacturers or importers. Such parties may be:

- regional wholesalers sitting down the supply chain supplying retailers, and who will pay the excise;
- other manufacturers who will value add or undertake some further processing over the goods;

- duty free shops for departing passengers or foreign tourists; or
- ship and aircraft catering service providers, supplying stores for ships and aircraft undertaking international voyages.

In these situations however, it should be noted that the excise liability is actually being transferred to another entity rather than being acquitted from the system altogether. Thus the excise liability in this situation is transferred 'off the books' at one business and 'on to the books' at another business. As such, simultaneously re-establishing the same liability in a new location. In some jurisdictions, this type of liability transfer is not 'simultaneous' rather the controls around the transfer will have one entity retaining the liability right up to the point where that liability is indeed accepted into the books at its destination.

4.1 Licensing of manufacture and dealing

In having a legal requirement for all entities dealing in excisable goods to be registered, licensed or in some way identified, the administering agency has full knowledge as to who is operating within the excise system and therefore will be creating excise liabilities.

The concept of this primary control of licensing is to ensure correct identification all excise liabilities, be that through manufacture of excisable goods, delivery of excisable services, import of excisable goods, or other acquisitions. The control operates primarily from the administering agency having full knowledge as to where excisable operations are taking place for the purposes of monitoring and tracking any liabilities created.

The actual 'granting' of such registration or licensing contributes to the effectiveness of the control by way of a 'review process'. Reviews help administering agencies to assess the adequacy of the applicant as a licensed entity within the excise system. The review process over the application enables the administering agency to reject an applicant who may pose an unacceptable risk of non-compliance and loss of revenue. Alternatively, the agency can enforce modifications to any part of the applicant's operations it considers to be an unacceptable risk of non-compliance and loss of revenue.

Working with this over-arching control of licensing are any number of subsidiary controls such as the ability to then restrict or condition in some way, the operation of that license with a view to protecting the excise revenue. At the first level, a license or registration can be issued against a tight scope, or in practical terms, issued for a specific activity, a certain location, a sole commodity, or a sole service delivery. Any of these serve to further reduce risks to the revenue. For example, licenses can be issued on the following basis:

- a single excise activity such as distillation of spirits, refining of crude oil, supply of lottery tickets, recycling of motor vehicle tires, etc., and
- to be conducted at a single business address or location, such as a street address.

Alternatively, a single business with operations across the whole supply chain may have a license issued for that purpose. For example, take a motor vehicle company involved in all aspects of the supply chain, authorities can issue a license in the following manner:

- to a single business entity;
- for the manufacture, movement, storage and sale of excisable cars;
- for the manufacturing plant, the storage depots, the regional distribution depots; and (perhaps)
- for car dealerships where orders for sales are taken from customers and new vehicles delivered for delivery to those customers.

The result of scoping licenses in this manner is to restrict the applicant to a single activity, or single range of related activities, at known and identifiable locations. The objectives of such restrictions are to allow administering agencies to control the nature of operations conducted. Furthermore, excise authorities will be able to reconcile such risk factors as the nature of the business applying for a license against the type of operation for which the licensee seeks a license.

Apart from setting the scope of a license or registration, further conditions can be set for the license or registration itself, providing further subsidiary controls to the licensing or registration process designed to mitigate risks of revenue loss. Again, these conditions can be specified dependent upon the applicant or the nature of the applicant's business.

Common forms of license or registration conditions could include:

- the creation and maintenance of business records to a standard set by the administering agency, and which are capable of demonstrating compliance;
- full and free access being available to those records, to the premises licensed, to the production machinery, to relevant apparatus such as flow meters, gauges and scales, and to any raw materials, partly manufactured goods and finished goods on the premises;
- notification of changes to relevant operational matters such as replacement of key personnel, financial systems, measuring equipment or any other material change; and/or
- the lodgment of some form of documentary (or cash) security relating to the size of potential excise liabilities, to be held in the event of revenue loss from the licensed entity.

Tobacco and the Protocol to Eliminate the Illicit Trade in Tobacco

Finally, in terms of tobacco products the Protocol to Eliminate the Illicit Trade in Tobacco (the "Protocol") calls for mandatory licensing of certain aspects of the tobacco supply chain including tobacco product manufacturing, importing, as well as manufacture and supply of cigarette making

machinery.[25] Licensing is an important tool for securing the tobacco supply chain. In fact, licensing is endorsed by Article 15, paragraph 7 of the FCTC, which states that "[e]ach Party to the FCTC ("Party") shall endeavor to adopt and implement further measures including licensing, where appropriate, to control or regulate the production and distribution of tobacco products in order to prevent illicit trade".

A licensing system, if accompanied by effective enforcement and deterrent penalties, can ensure that (1) only legitimate, qualified and law-abiding (including fiscally compliant) businesses are engaged in the manufacture, importation, distribution, marketing and sale of tobacco products and (2) all industry entities trade in tobacco products only with other licensed sources.

Tobacco industry participants would be required to obtain a license and to fulfill any related requirements before they can trade in tobacco products and would only be permitted to trade with other licensed participants. Members of the tobacco supply chain that violate the terms of the licenses would risk a temporary suspension or, if repeat offenders, permanent revocation of their licenses to trade in tobacco products. Licensing schemes would also require some level of government reporting, auditing and oversight.

Licensing can also assist in implementing other regulatory requirements for the tobacco industry, such as product regulation or as a tool for preventing youth access to tobacco products.
Paragraph 1 of Article 6 generally requires legal or natural persons to be licensed in order to pursue any of the following specified activities:

- manufacturing (i) tobacco products or (ii) manufacturing equipment used in the manufacture of tobacco products; and

- importing or exporting (i) tobacco products or (ii) manufacturing equipment used in the manufacture of tobacco products.

It should be noted that Article 6 distinguishes between "tobacco" and "tobacco products," defining the latter as "products entirely or partly made of the leaf tobacco as raw material which are manufactured to be used in smoking, sucking, chewing or snuffing". The term "tobacco" presumably refers to leaf tobacco, but this point should be clarified. The threshold amount for the different activities above which a license would be required is country specific.

Retail licensing
In countries where a large informal sector exists, retail licensing will not be feasible[26]. In these countries, the threshold amount should be set high enough to exclude retailers from licensing requirements. As a reasonable alternative to licensing in these countries, retailers could be required to register with a public registry. This would benefit the local governmental authorities and small retailers by reducing the administrative burden of licensing.

[25] Article 6
[26] The Framework Convention Alliance recognizes the difficulties of licensing retailers: "Licensing retailers can be costly to administer, and difficult to establish if the country's infrastructure is not well developed. Where there is a large informal sector, retail licensing probably will not be feasible. See fctc.org/modelguide/lsection05.html

This approach is also defined as "negative licensing." Negative licensing differs from other, more burdensome licensing by only requiring retailers to notify the authorities. Negative licensing also allows retailers to be sanctioned for failing to comply with applicable regulations.

Scope of the license Article 6 does not address the scope of the licenses to be issued. There are two possible approaches, namely: (i) a general license issued to a person engaged in a number of related activities (for example, manufacturing and exporting tobacco products) that would cover all licensed activities, and (ii) multiple licenses issued separately for each activity so that, for example, a person engaged in manufacturing and exporting would be required to obtain two separate licenses (e.g., one for manufacturing and another for exporting).

The general license approach has the advantage of reducing paperwork and the administrative burden of granting and monitoring licenses.

Paragraph 3(a) requires each Party to "establish or designate a competent authority or authorities to issue, renew, suspend, revoke and/or cancel licenses…". The Parties should designate the agencies that already possess enforcement and audit capabilities (for example, Customs agencies and revenue authorities) rather than establish new licensing agencies.

The reason for this preference is that the established agencies could leverage their expertise in related matters. In addition, the costs of the additional licensing function would be incremental compared to those for newly established licensing agencies. This will be a critical decision within the region in the context of licensing the relevant aspects of the tobacco supply chain.

License fee
Paragraph 3(c) provides that the Parties shall "monitor and collect, where applicable, any license fees that may be levied and consider using them in effective administration and enforcement of the licensing system or for public health or any other related activity in accordance with national law." The license fee amount should be set to correspond to the amount necessary for effective administration and enforcement of the licensing system. The fee should be specific to the activity for which a license is sought, and not based on turnover. The license fee proceeds should be earmarked for the effective administration and enforcement of the licensing system (and supplemented, to the extent necessary, by any fines collected for license violations).
In general, the negative licensing scheme mentioned above could also be considered as a viable option to reduce corruption practices linked to the issuance, renewal or cancellation of licenses (as opposed to the payment of a fee) because it removes the economic incentive for such unlawful practices to take place.

Licensing of key inputs
Since key cigarette manufacturing inputs were not included in the scope of the Protocol, it is important that this issue be considered country-by-country as Parties enact the Protocol provisions into domestic law. The inclusion of key inputs into the licensing scheme could provide an effective measure in fighting against the illicit trade in tobacco products. This is because it would allow for the introduction of an accountability mechanism to improve supply chain controls measures on key

components (such as cigarette tows and ready-made cigarette filters) that are necessary for the manufacture of cigarette

DISCUSSION QUESTION
- WHAT LEVEL OF LICENSING DOES YOUR COUNTRY HAVE?
- SHOULD THERE BE MINIMUM STANDARDS FOR LICENSEE APPLICATIONS TO MEET?

4.2 Record keeping, accounting and reporting of liabilities

There are several types of records and reports are used for identifying and tracking excise liabilities. Different records are necessary to adequately track the excise liability as it moves from creation to acquittal. The reporting of licensee operational details should be simple for both industry and revenue agencies. Progress can be made through increasing the use of electronic returns based upon, or created directly from, the licensee's usual commercial records.

The main areas of activity for formal monitoring will relate to the three key excise system components outlined in Figure 1; liability creation, liabilities on hand, and liability acquittal.

In terms of reporting against excise liability creation, authorities need to consider the means in which that liability is created, establish the correct liability and ensure that it is accurately accounted for in the licensee's records.

Liability creation originating from imports of finished excisable goods or receipts of finished excisable goods from other licensees can be reconciled fairly comfortably. In this case, reconciliation occurs through reference to the relevant transactions conducted with the local Customs agency (possibly the same agency administering excise), or reference to the records of the business that has dispatched the finished goods.

The issue of liability creation from manufacture is somewhat different and more complex. It will differ from product to product and perhaps from production technique to production technique for the same type of product. However, the underlying objectives are the same – to be able to reconcile raw material inputs to final production of excisable goods.

Many factors make this a difficult process and for illustrative purposes, look at the following factors as they apply to a liquor distillery:

- the nature of the raw material, for example, how much sugar is in the fruit being fermented to make liquor;
- whether there is wastage of raw materials as part of the production process;

- whether there are losses of raw materials, partly manufactured or manufactured products as part of the production process, such as liquids left in pipes or tanks;
- the efficiency of the production process, that is, can all raw materials be recovered; and
- whether there are processes such as sampling for quality control, sampling for fill, sampling for strength, etc., which require finished goods to be consumed as part of the overall manufacturing process.

Records to be kept by distillers facilitate the reconciliation of raw material inputs, in this case a mash of material for fermentation, a 'wash' of fermented material for distillation, and the resultant spirit from distillation. The purpose of such records allows officials to find a ratio of fermentable materials to a fermented wash, or the volume of fermented ethyl alcohol produced during the fermentation process. From this point, records can compare the alcohol present in the final distilled spirit product with the alcohol present in the fermented wash that went into the distillation.

Whilst variations will be expected in ethyl alcohol produced from batch to batch as raw materials are fermented, the ratio of fermented alcohol to raw material inputs should become clear over time. Indeed, a range of expected production is likely, where a specified amount of raw materials is used. Deviations from that expected range would see the licensee called to account as it could mean the potential for undeclared production. Likewise, the expected efficiency of the distillation operation will become apparent over time when comparing the amount of alcohol recovered in distillation with the amount of alcohol in the fermented mash which was put into the distillation process. Again, deviations from the expected range of alcohol recovery in the still could mean undeclared production.

These same principles will apply to the manufacture of any excisable goods; in particular, the measurement of raw material and other inputs against final production figures and efficiencies in production established.

Once excisable goods are manufactured (or imported) as finished goods, a number of activities are likely to occur in which the liability created is subsequently acquitted, transferred or written-off in some way. For licensed manufactures will then record this information separately. As a result, finished goods from production are translated into records that relate to inventory which is to be held by the licensee until the duty is paid and delivered, or the product is delivered to another licensed operation and the liability transferred out, or some other form of liability acquittal occurs.

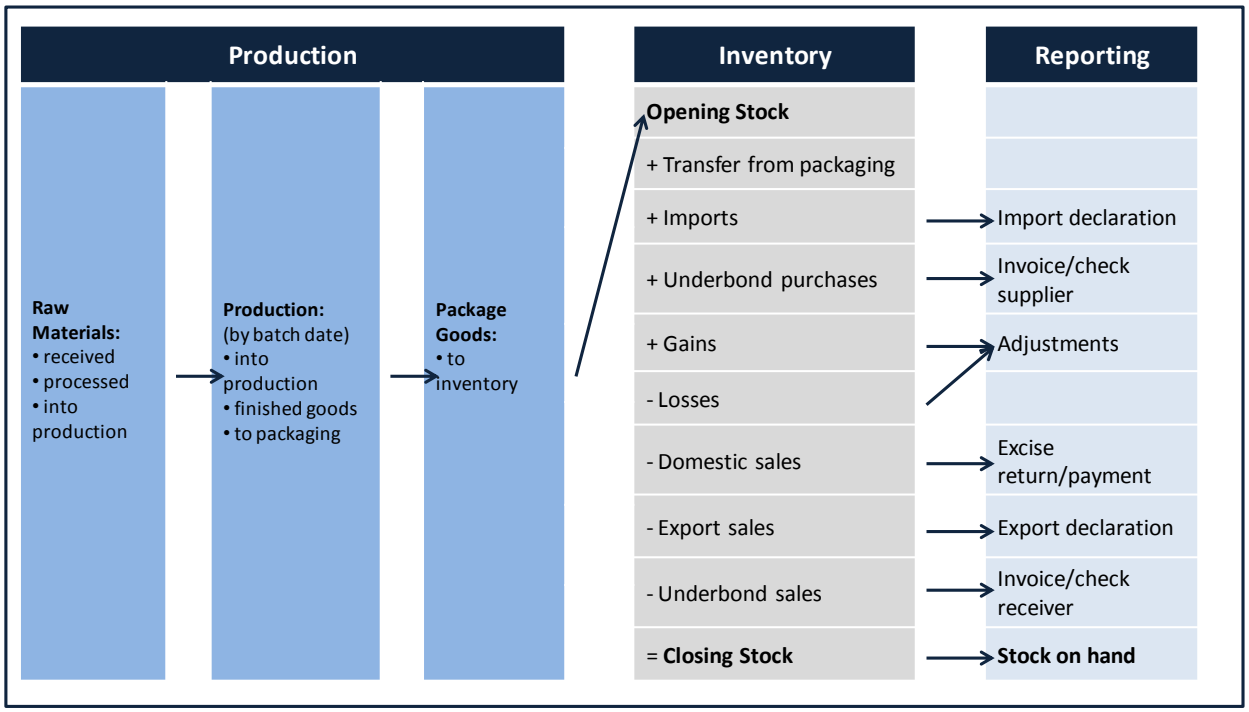
In terms of inventory, the licensee needs to tracks liability by starting with an opening balance for an accounting period, then adding to that liability from the different categories of receipt. Such examples include the production run, or perhaps an import for which there will be a customs declaration or perhaps an under-bond purchases for which there will likely be some form of approval or permission to receive such goods. Then there may be gains or adjustments for which some form of approval or internal record to support the quantity and source.

There are various categories for deducting excise liability such as duty paid deliveries into the home market for which an excise return or declaration will exist, exports, diplomatic sales, losses, and destructions of stock. All of these will have some form of supporting approval or internal records to support the deduction of the liability.

This leaves a closing balance of liabilities for the accounting period, from which a stock take provides a means of physically verifying the balance.

In order to illustrate the record keeping, accounting and reporting controls that should support an excise system, Figure 2 sets out the nature and flow of such records, reports and accounting that should be required to be in place at each licensed operation.

Figure 2: Record keeping, accounting and reporting at excise licensed operations



4.3 Duty payment, refunds and adjustments

Excise liability is generally acquitted by either the goods or services passing the 'taxing' point and being brought to account with appropriate payment of excise duties, or the liability being in some way 'written-off' through losses, destruction or deterioration of goods whilst they are still within the licensed premises. We have already looked other ways in which licensees can acquit liability such as under bond sales or exports however, this section focuses on excise duty payment.

The principal liability acquittal mechanism is the goods or services passing the taxing point and triggering the requirement for the liability to be brought to account and remitted. Just exactly when this liability is brought to account and remitted will depend on local excise law, but increasingly

this process is self-assessed and the reporting and payment of excise duties relating to deliveries of goods and services are performed periodically. *However, in the ASEAN region it is still common for some excisable goods to 'pre-pay' excise prior to the taxing point. In fact, they cannot deliver such goods past the taxing point unless producers or importers have already pre-paid the excise duty.*

Authorities can achieve this approach through several means. Firstly, the licensee may need to make some form of declaration or return relating to excisable goods intended to be delivered, pay an amount of excise duty relating to those intended deliveries, and await some form of clearance or other authority that delivery can take place. This could, for example, be upon assessment as to the accuracy of the return, or perhaps the clearance of funds when paid in the form of a cheque.

The alternative approach to 'pre-payment' is through a tax strip or tax stamp system in which licensees estimate deliveries, calculate their excise liabilities, acquire tax strip stamps to that value and affix them to individual product packaging prior to delivery. Tax strip stamps are most popular with tobacco and alcohol products which by nature are subject to high tax rates, and are vulnerable to high levels of tax evasion. This approach can apply however to other commodities.

The main objective of the use of tax strip stamps is as a control over tax avoidance, although authorities have extended their use to controlling counterfeit products. The tax strip stamp is both a means of reconciling taxes paid against volumes of excisable product leaving a bonded warehouse and as a real time indication as to whether a product in the marketplace has had the appropriate tax paid.

There is much debate about the security, effectiveness and reliability of paper tax stamps and as such there have been significant recent developments in improving the security, quality and usefulness of such tax strip. Included in these developments are digital tax strips which contain data over the goods. These modern mechanisms utilise supporting technology that should enable identification goods as genuine tax paid products with information as to origin of production. These developments will form part of the next section of the paper as "tack and trace" technology has become a key part of the Anti Illicit Trade in Tobacco Protocol.

In such self-assessment based excise systems, pre-payment is not the preferred form of excise reporting and payment, rather the focus is on periodic reporting and payment of excise liabilities. This means that licensees operate to an accounting period that reports any deliveries past the taxing point for that period. Licensees then file this report and associated payment of excise on a due date set for each accounting period.

The extent to which reporting deliveries occurs depends on the local excise administration. However, there are several common key objectives in any such excise payment return. Firstly, the total excise duty due and payable needs to reconcile with the physical payment made by the licensee, whether that be by an electronic transfer, cash or cheque. Secondly, the administering agency can use the detail relating to volume or values of the differing types of deliveries to remotely monitor the nature and extent of both excisable and concessional sales with a view to establishing norms in such sales. Finally, there are statistical objectives, allowing agencies to

monitor revenue receipts and sales across industry sectors, like operations, or across the entire excise system.

With the nature of excise duties, particularly as they relate to manufacturing and distributing goods, there will be a need for adjustments to these periodic return amounts. Whilst it is common in the compilation of any type of tax return to find errors and omissions for adjusting, excise manufacturers in particular are also dealing with issues such as:

- incorrect deliveries such as incorrect stock, or incorrect volumes or quantities selected to fill orders;
- returns of stock due to those reasons above, or due perhaps to a fault or deficiency in the product, or customer simply seeking a return and refund;
- incorrect classification of deliveries such as domestic sale being classified as an export, an end use requirement not being fulfilled, or a required end user not taking delivery;
- failures in recording and measuring systems detected such as pipes, flow-meters, gauges or scales;
- incorrect delivery date reported causing payment to occur in wrong accounting period; and
- the goods deteriorate, perish, break or otherwise become unsaleable.

There are generally two ways to address adjustment issues. Firstly, allowing for the adjustment to apply to the excise return for the current (or to a future) accounting period being reported. This is achieved by ensuring that there is provision in the excise return document which permits the making of adjustments which will impact on the excise payable on the current return. Notwithstanding, as with any details provided on an excise return, the statements need to be supported by appropriate records to substantiate the adjustments being sought.

Alternatively, a document separate to a return could be required in which the licensee seeks application for the administering agency to grant a refund of excise payable. This refund could be payable to a nominated bank account, by cheque, or by a credit of excise tax which can be applied against a future excise payment. This process is also used in those situations in which excisable goods have not been delivered and the licensee wishes only that the relevant liability be ‘written-off’ their books.

In those jurisdictions in which a separate application process is in place, they will also require a similar process for licensees to make any increasing adjustments or provide for those situations where additional excise duties need to be reported and paid. Here, similar errors and circumstances to those listed above have actually caused under-payments of excise which need to be declared and remitted.

In terms of refunds, credits, or write-off of excise duties, it is generally a requirement that the licensee has to meet various criteria or be subject to certain conditions in order to be granted an excise refund or credit.[27] Often these criteria are prescribed in law, and are designed to ensure that excise refund policy is not 'under-writing' poor business or commercial decisions. As excise can often be a major cost component of the price of such goods, easy access to full refunds does remove certain risks from a business.

4.4 Tracking and Tracing

Whilst 'tax stamps' have been discussed above in the context of a 'duty payment' related control the effectiveness of this type of paper based tax strip as confirmation of a tax paid status is now being questioned. In most cases, a paper tax stamp cannot provide a true guarantee that all duties have been paid – as tax stamps have easily been counterfeited, re-used, applied to the wrong product, damaged, etc. Whilst there have been some improvements to the quality and security of tax stamps, the approach is still at best "passive" authentication only accessible for highly trained users with special equipment such as proprietary scanners. This minimizes the reach and effectiveness of such domestic authentication and tax verification systems because basically all supply chain members cannot use these features and therefore not help in the fight against counterfeiting and tax evasion.

Effective tracking and tracing requires the implementation of robust and secure coding and data management systems in typical countries of diversion. Any such system needs to be designed based on open data and coding standards so that data can be exchanged easily between different IT platforms with different levels of sophistication and that coding can be read with standard secure reading devices already in use by many customs authorities, members of the supply chain, and manufacturers. This approach reduces cost, dependency on proprietary solutions, while increasing reach, effectiveness and inter-operability between different countries, platforms, and existing systems.

It is important for this issue to be looked at not just regionally, but eventually, globally. The risk is that individual countries building their own domestic monitoring systems will be largely ineffective as tracking and tracing products across borders becomes difficult with incompatible systems cannot communicate critical data between the agencies of each trading partner. Thus there needs to be a move towards a 'standard' within the tracking and tracing concept for coding and data. This issue is recognized in the same manner across various industries such as for instance the pharmaceutical sector. McKinsey[28] just concluded in a recent study that they only workable way are open global standards when it comes to improving supply chain security.

On the other hand, implementing an international standard of secure coding and data management systems would enable law enforcement authorities to easily retrieve, through a single access point

[27] Apart from Canada Figure 6, see also, for example: Regulations 60-64 Customs & Excise Regulations 1996 (New Zealand); Regulation 50 Excise Regulations 1925 (Australia) paragraphs (1)(a) – (1)(zzd); or beer under Sub-part T, clauses 25.181 – 25.284 Code of Federal Regulations (United States); or Central Excise Rules 2002 / Export of Service Rules 2005, Customs and Central Excise Duty Drawback Rules 1995 (India).

[28] See page 5 of "Srength in Unity" (McKinsey, October 2012).

and in a standard format, information about the product, its manufacture, distribution and legal status, including products in transit.

The emerging technology in this area is known as "track and trace" in which products are marked with a unique identifier. The serialization is generally applied during the manufacturing on the packaging line for which all data relating to the product and its manufacture is generated and is accessible by the relevant tax authority.

Tracking relates to the ability to monitor a product in the supply chain. The unique identifier can provide instant confirmation that the product is genuine, then importantly confirm details of the product itself, including its manufacture (and the status of tax and duty payments). Tracking is an excellent tool for agency field auditors, or for responding to complaints of suspicious products in the market. As technology improves, so does the level of information that will be captured.

Tracing relates to the ability to recreate the movement of the product down the supply chain. This will include details of wholesale customers, dates and places for which information could come to light to assist in the identification of where diversion, smuggling or tax evasion may have occurred. In short it becomes a source or a tool for investigators, not just field auditors.

Whilst the track and trace solution seems to be an ideal solution to confirming authenticity and details of the product, some areas of discussion are required. Track and trace technology alone will not be sufficient in addressing problems associated with high levels of non-tax paid activity for excisable products.

The main area of concern is that some systems are of high cost, and in particular, responsibility for meeting the investment and operational costs. Some comprehensive digital coding track and trace systems are already operational in licensed manufacturing premises and could be used to provide a low cost and already operational system for enforcement agencies. It is not desirable for track and trace technology to add to the risks of tax evasion and smuggling. This is counterproductive, given the purpose of the technology to deter tax evasion and smuggling.

As with "licensing" above, the Protocol to Eliminate the Illicit Trade in Tobacco Products calls for the ambitious creation of a global track and trace system, built from national and regional track and trace systems.[27] The Article of the Protocol will require countries to implement a system which is based on the application of unique markings affixed to packets, cartons and master-cases in which the following data is accessible:

- date & location of manufacture;
- manufacturing facility;
- machine used to manufacture;
- production shift / time of manufacture;

- name, invoice, order number and payment records of the first customer not affiliated with the manufacturer;
- intended market of retail sale;
- product description;
- any warehousing & shipping;
- identity of any known subsequent purchaser; and
- intended shipment route, date & consignee.

To-date, digital coding systems are operational and effective in the tobacco industry, in which very high-speed production lines raises effectiveness issues in regards to the tracking & tracing capabilities of paper based strip systems.

The Protocol is designed for tobacco products, although the track and trace concept can be applied to virtually any excisable goods. Manufacturers will apply details of the product at packaging through coded information about the product put on to labels and often through bar-codes, QR codes etc. The data stored within the label becomes a mechanism for tax authorities to be able to confirm the authenticity of the product, and have knowledge of production details, batch details and limited distribution history.

DISCUSSION QUESTION
DOES YOU COUNTRY USE TAX STAMPS? IF SO, FOR WHAT PRODUCT AND WHAT SECURITY FEATUES ARE IN THE STRIP?

5. ANALYSIS OF KEY PRODUCTS SUBJECT TO EXCISE TAXATION IN ASEAN

5.1 Tobacco products

The results of Phase I clearly illustrate that tobacco excises are levied on different bases and at widely varying rates across the 10 countries. Brunei and Singapore have the simplest (single tier) specific tax regime, while Indonesia and the Philippines taxes cigarettes at a different specific rates based on how they are priced (Philippines) made or on their product characteristics, volume levels and prices (Indonesia) . Cambodia, Laos, Myanmar and Vietnam utilize an ad valorem regime based on the production costs (Ex-factory/CIF) and Malaysia and Thailand use both the ad valorem and specific components to calculate the tobacco excise duty (only the greater component applies in the case of Thailand, which currently in practice results in a fully ad-valorem system).

5.1.1 Overview of Tobacco Excise Taxation

Excise tax imposed on tobacco products generally serves two main purposes. One is to generate revenue and maximize tax income; the other is to reduce consumption of tobacco. Employment is an additional important consideration for some countries in developing their excise policies. A challenge is to find the optimal level of taxation whilst taking into account the above objectives.

The key components in designing the appropriate tobacco excise tax regime are the structure of the regime, i.e. ad valorem, specific or the mixture of the two, and the excise tax rate. These two key components and their potential effects must thus be thoroughly understood.

Excise Tax Regime

WHO[29] observed that, in general, low-income countries are more likely to lean towards an ad valorem excise system while high-income countries are less likely to do so. In Asia Pacific, specific excise system is the most used regime for tobacco excise tax. Example of the countries with a specific tax outside of the ASEAN members include Australia, Hong Kong, India, Japan, Pakistan, South Korea, New Zealand and Taiwan. China utilizes a mixed system similar to that of Malaysia and Bangladesh is the only country in Asia Pacific that has an ad valorem tobacco excise tax system apart from Cambodia, Laos, Myanmar and Vietnam.

Specific and ad valorem excise taxes have different impact on prices, tax revenues, product quality, product variety, and administration. Therefore, the key challenge for policy makers is how to choose which type of excise to levy and at what rate, or find the best balance in the mixture between specific and ad valorem excises, so that the public policy objectives, being public health or revenue generation, employment or others, are appropriately achieved. We highlight the advantages

[29] World Health Organization (WHO). 2010. WHO Technical Manual on Tobacco Tax Administration. Geneva: WHO Press.

and disadvantages of specific, ad valorem, and the mixed excise systems in the a table below, focusing on important aspects such as the implications on government revenue stream, ease of administration, value erosion from inflation, sensitivity to macro-economic fluctuation, and protection of state enterprise or domestic industry.

Table 11: Implication of different tobacco tax systems

	Advantage	**Disadvantage**
Specific	Easy to predict government revenue Independent from industry's pricing strategy Easy to determine tax amount Easy to administer Consistent with both revenue and public health objectives	Inflation erodes its value
Ad Valorem	Automatic adjustment for inflation Progressive rate	Less predictable revenue stream Difficult to determine value of products to be used as tax base Require significant administrative resource Can be affected by industry's pricing strategy Lead to down-trading and higher consumption of low-price brands
Mixed	Less fluctuation in revenue stream Can keep up with inflation Does not favor high- or low-priced products Less affected by industry's pricing or product strategy Consistent with public health objectives	Complex system requires significant administrative resource

Excise Tax Rate

Under any given excise tax regime, key considerations for the excise tax rate will involve the following:

A. Should there be a single excise tax rate or multiple rates?
B. Should there be different tax levels for different product categories?
C. What should be the level of the excise tax rate?

Each of these has profound implication and needs to be looked at in more details.

A.Single vs Multiple Rates (for products in the same category)
In general a single rate would be preferred to multiple rates for products in the same category, e.g. a single tax rate for all cigarettes. This is so because the multiple rates would immediately require sub-classification of the products according to the appropriate criteria established (for example, production volume, price, etc.). Such classification exercise adds complexity to the excise tax system. Furthermore, it could also be considered as discriminatory measure if the criteria is set in a way that favors one group of products over the others, domestic versus import, for instance.

B.Should there be different tax levels for different product categories?
Tobacco products come in many different types and forms such as cigars, cigarettes, kretek and RYO. For consumers, some products are generally substitutable goods, however, for policy makers they can be very different. Being substitutable means consumption will likely concentrates around cheaper products. Having different tax levels for different product categories can amplify such outcome. This is often used as tools to protect specific sectors within the industry. Policy makers need to carefully consider the implementation of such differentiating mechanism and how it would affect the revenue and health objective of the overall tax measure.

C.The Excise Tax Rate
The setting of the excise tax rate is critical as it plays a crucial role in determining the final price, and thus the affordability of the product, which in turns, affects demand and of course the tax revenue collected. Although, it is often viewed by the government that raising the tax rate is an effective way to raise tax revenue, the economic theory suggests that random and excessive tax increase could be harmful to the economy (Pindyck, 1988; Bizer and Judd, 1989). Indeed, experience in some countries suggests that a policy of ad-hoc sharp tax increase can have unintended consequences such as down-trading to lower taxed legal or illegal products on which no tax is paid. This has a negative impact on both the Government's revenue and the health objectives.

5.1.2 Tobacco tax systems across ASEAN

A number of ASEAN countries still rely on the ad valorem excise tax system for tobacco products. The attractiveness of the system for these countries could be its effect in favouring the lower-priced products produced by the state-owned enterprises. However, when looking at a broader regional level, no country outside of ASEAN (except for Bangladesh) uses the ad valorem tax system.

Figure 3 shows that the specific system is the most widely used in Asia Pacific while China and Malaysia are the only two countries to use mixed system.

ASIA Pacific Tobacco Excise Tax Landscape

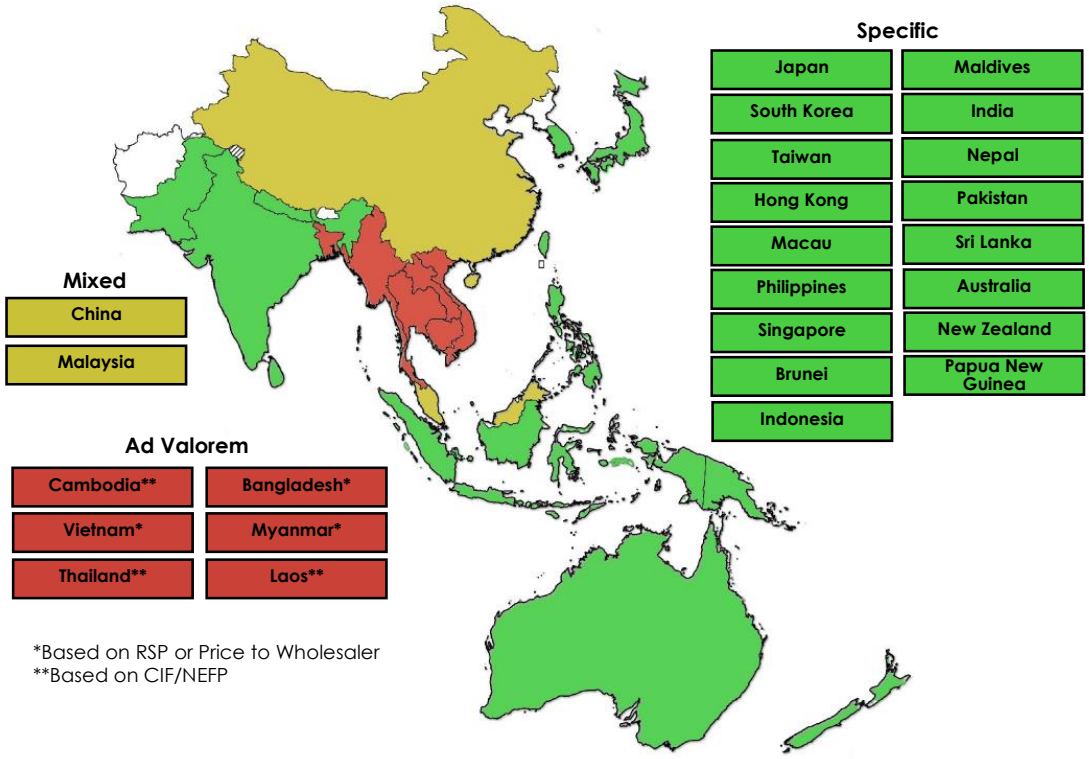


Figure 3: Asia-Pacific excise tax structure adapted from Tobacco Excise Taxation in Asia: Recent Trend and Developments by Emil M. Sunley

The below sections looks at the tax system for each of the ASEAN member countries in more details.

A. Brunei Darussalam

At present, the tobacco market in Brunei is almost exclusively of imported products. There is no import tariffs levied on imported tobacco in Brunei and hence excise duty is the only taxation method. The current applicable excise regime is a single tier specific and is charged based on the type of tobacco product.

Tobacco Product	Excise Rate (BND)	Measurement
Cigarette	0.25	Per Stick
Cigar, cheroots and cigarillos	200	Per Kilogram
Beedie, Kretek	60	Per Kilogram

Table 12: Brunei tobacco excise tax

B. Cambodia

Cambodia levies ad valorem excise tax on tobacco products based on costs, i.e. net ex-factory price ('NEFP') for domestic products and CIF plus import duty for imported ones.

Tobacco Product	Ad Valorem Excise Rate Based on Cost
Cigarette	10%
Cigar	25%

Table 13: Cambodia tobacco excise tax

C. Indonesia

Indonesia uses a multi-tier specific excise tax system for tobacco products. Classification criteria are types of product, mode of production, production volume and price. This results in a rather complicated structure of many tiers (13 for cigarettes and 5 for cigars) with details as shown in the table 14 below.

Product (Mode of Production)	Specific Rate IDR/Stick	Amount of Production/year	Retail Price/stick
Kretek (Machine Made)	370	> 2 billions sticks	>669
Kretek (Machine Made)	355	> 2 billions sticks	631-669
Kretek (Machine Made)	280	≤ 2 billions sticks	>549
Kretek (Machine Made)	245	≤ 2 billions sticks	440-549
White cigarettes	380	> 2 billions sticks	>680
White cigarettes	245	≤ 2 billions sticks	>444
White cigarettes	195	≤ 2 billions sticks	345-444
Kretek (Hand Made)	275	> 2 billions sticks	>749
Kretek (Hand Made)	210	> 2 billions sticks	550-749
Kretek (Hand Made)	130	> 0.3 billions - 2 billions sticks	>379

Kretek (Hand Made)	120	> 0.3 billions - 2 billions sticks	349-379
Kretek (Hand Made)	110	> 0.3 billions - 2 billions sticks	336-349
Kretek (Hand Made)	80	≤ 0.3 billions sticks	>250
Cigar	100,000	no production classification	>180,000
Cigar	20,000	no production classification	50,000-180,000
Cigar	10,000	no production classification	20,000-50,000
Cigar	1,200	no production classification	5,000-20,000
Cigar	250	no production classification	<5,000

Table 14: Indonesia tobacco excise tax

Key points:

- The current structure with 13 tiers for cigarettes (originally 19) is to be adjusted in order to reduce the number of tiers to two as per Government's excise structure roadmap adopted in 2009 (one tier for machine-made and one tier for hand-made "kretek" cigarettes).

D. Laos

According to the regulation Laos utilises a single rate ad valorem excises – 60% based on costs for all categories of tobacco products. In practice, due to existing licensing agreement with the industry, a rate of 15% -30% applied on costs (Ex-factory price for domestic products and CIF plus duty for imported ones). There is also LAK 500 additional specific tax.

E. Malaysia

Malaysia uses a mixed system mainly consisting of specific with a small ad valorem component (based on costs, i.e NEFP less security ink exemption for domestic products and CIF plus import duty for imported ones) as shown in the table 16 below.

Product	Specific Rate (Ringgit)	Base for Specific Tax	Ad Valorem Rate
Cigarettes	0.22	Per Stick	20%
Cigars	220	Per Kilogram	20%
Beedie/Kreetek	7.50	Per Kilogram	5%
RYO	27	Per Kilogram	5%

Table 15: Malaysia tobacco excise tax

F. Myanmar

Myanmar levies a commercial tax on tobacco products, at a flat ad valorem rate of 50 per cent.[30]

Key points:

- Myanmar currently applies an import licensing scheme that restricts imports of tobacco to duty-free and hotel sales only.

G. Philippines

Since January 1st, 2013, Philippines utilizes a two-tier specific regime for cigarettes differentiated by price, a specific tax for RYO and uses a mixed structure for cigar as shown in the table 17 below.

Product	Specific Rate (Peso)	Base for Specific Tax	Ad Valorem Rate
Cigarettes			
- Packed by hand	12	Per Pack of 20	N/A
- Packed by machine			
-- Up to 11.50 NRP per pack	12	Per Pack of 20	N/A
-- >11.50 NRP per pack	25	Per Pack of 20	N/A
Cigars	5	Per Stick	20% on Net Retail Price
RYO	1.75	Per Kilogram	N/A

Table 16: Philippines tobacco excise tax

Key points:

- The two-tier structure is moving to a single-tier in 2017 with 4% annual increase in the rate in line with projected inflation.

H. Singapore

Singapore has a single-tier specific excise tax system levying SGD 0.352 per gram per stick of cigarette and SGD 352.00 per kilogram of RYO.

I. Thailand

Thailand has a rather more complicating tobacco excise tax system than the other ASEAN's members - a "dual" ad-valorem and specific system where the higher rate applies. Table 17 below illustrates the current applicable rates.

[30] Phase 1 Survey

Product	Specific Rate (THB/Gram)	Ad Valorem Rate
Cigarettes	1	87%
Cigars	1	20%
RYO	0.01	N/A

Table 17: Thailand tobacco excise tax

For cigarettes with the current applicable rate, the system is a *de-facto* ad valorem system, with a minimum excise tax (MET) of approximately THB 20 per pack. The ad valorem component is based on cost (NEFP for domestic products and CIF plus duty for imported ones).

Key points:

- The "inclusive" nature of the Thai excise tax requires a complicating formula to calculate the ad valorem tax component. Due to such complex calculation, the announced ad valorem rate does not necessary reflect the actual tax burden (87% translates to almost 670% effective rate).
- The current system is effectively a purely ad valorem system, once a certain price point is passed. Any increase in the rate will always widen the price gap and will lead to trading down behaviour.

J. Vietnam

Similar to the neighbouring countries, Vietnam uses an ad valorem tax structure, albeit with a single rate of 65% for all product categories based on NEFP or CIF.

5.1.3 Tobacco Excise Tax for the AEC

At present, the widely varying excise tax for cigarettes between ASEAN member countries results in large differences in tax burden as well as the product's price to consumers, as illustrated in the Figure 4 below.

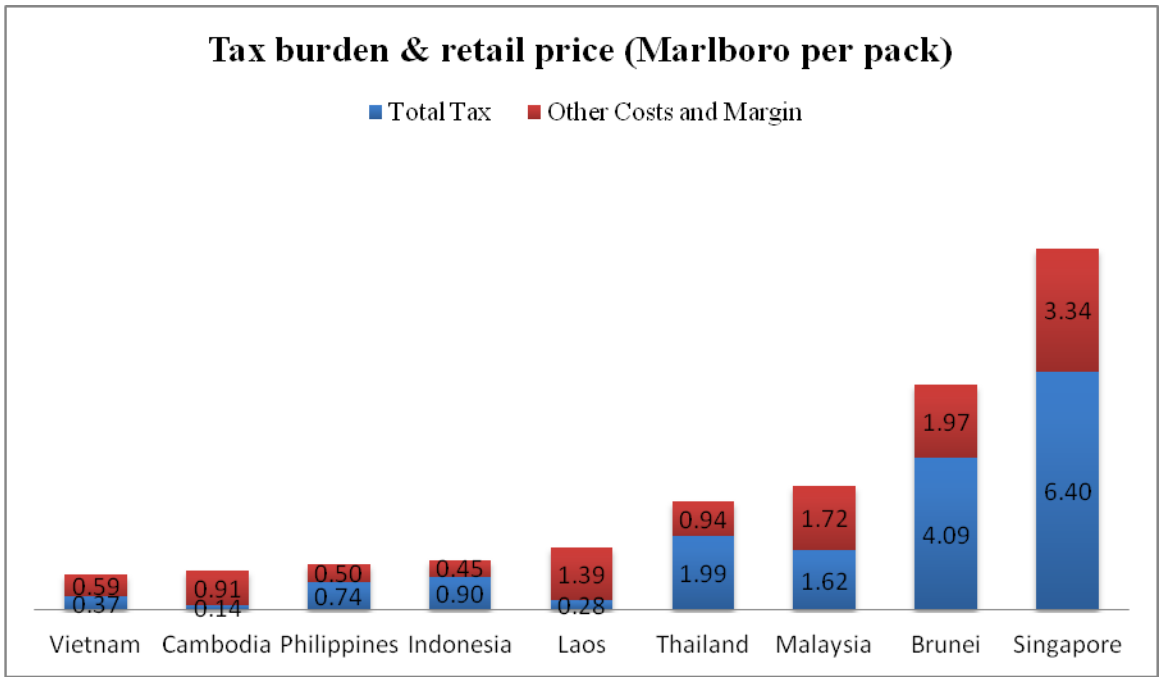


Figure 4: Cigarette tax burden and retail price

Source: PMI; calculations based on Marlboro cigarettes as of January 2013

Given the diverse levels of economic development in the region it is reasonable that the tax-driven retail price exhibits great differences. In fact, it would not make economic sense for the less developed countries such as Cambodia or Laos to tax a pack of cigarette as high as Singapore. The fact that border control will still exist, further suggests against a single tax rate for tobacco products.

Nevertheless, there may be benefits in having the same goal or following the same guidelines based on best practices when determining the tax regime and the tax rates so that all AEC members share the same standard and principle.

> Tax regime: the economic theory and principle suggest that a specific tax regime is most appropriate for goods associated with externality, including tobacco products. The same should be indexed for inflation so that the tax in real term does not devalue over time.

In the interim, a move away from a purely ad valorem system may be considered. A mixed system can deter the trading down effect by alleviating excise tax's pressure on product pricing and is more consistent with the health objective. A mixed system gives greater flexibility to the government in terms of policy design and with appropriate calibration of each element, i.e. specific and ad valorem it can be a very effective excise tax regime. It is, however, important to understand that the greater flexibility offered under a mixed regime also comes with finer details to consider when identifying the different components under the regime, which must be designed carefully.

DISCUSSION QUESTION:
WHAT ARE THE CONSIDERATIONS THAT FAVORS THE AD VALOREM TAXATION IN YOUR COUNTRY?

Tax rate: the determination of the appropriate tax rate should be left to the decision of each country so that tax sovereignty is maintained. However, the tax rate setting exercise needs to be based on the principle of non-discrimination. In determining the appropriate tax rate, the best practice would be to consider, at a macro level, the levels of economic development and key indicators, such as GDP per capita, employment and inflation. Rate adjustments should be done in moderation based on a clearly defined criteria and frequency.

"In setting tobacco tax rates, governments need to take into account several factors, including the impact of smuggling, cross-border shopping, and duty-free purchases on ferries and planes. It is in the interest of government to reduce tobacco smuggling not only to increase excise revenues but also to limit the loss of revenues from other taxes, including income and value-added taxes, as underground transactions replace legal ones. Ultimately, tobacco excise tax rates must reflect the purchasing power of the local consumers, rates in neighboring countries, and, above all, the ability and willingness of the tax authority to enforce compliance". - World Bank 1999. "Curing the Epidemic: Governments and the Economics of Tobacco Control".

DISCUSSION QUESTION*:*
CAN WE ATTAIN A STANDARD FOR TOBACCO TAX WHICH IS:

- *A SINGLE RATE STRUCTURE*
- *HAS AFFORDABILITY AS PART OF THE CONSIDERATION IN RATE SETTING*
- *BASED ON A GUIDELINE WHICH MEASURES AFFORDABILITY*

5.2 Alcohol beverages

Alcohol excise is levied in a variety of ways across the ten ASEAN countries, which is reflected in the results of the Phase 1 survey. As outlined in Chapter 3, ASEAN countries presently utilise a range of methods to calculate excise payable on locally-made or imported alcohol beverages, namely:

- *Specific/volumetric taxation:* according to alcohol strength of the product measured in litres of pure alcohol (LPA);
- *Unitary taxation:* according to the total volume of liquid in the product;
- *Ad valorem taxation:* dependent on the value of the product; and
- *Mixed/hybrid taxation:* products are levied a combination of specific and ad valorem taxation.

Alcohol beverages are levied a range of different internal taxes across ASEAN. These taxes carry a range of formal titles, including 'special consumption tax' (e.g. Vietnam), 'liquor tax' (e.g. Thailand), 'specific tax on certain merchandises and services' (e.g. Cambodia), 'commercial tax' (e.g. Myanmar) as well as 'excise duties' (e.g. Indonesia, Malaysia and Singapore). Furthermore, all ASEAN countries levy a customs duty on imports of at least some alcohol beverages into their jurisdiction.

Alcohol taxation across ASEAN varies in terms of application and complexity. A regional analysis of alcohol taxation across ASEAN demonstrates that there are numerous challenges towards achieving greater regional integration through the AEC 2015 process. Particular challenges in the context of alcohol beverages are outlined below.

5.2.1 Overview of ASEAN alcohol markets

Alcohol market characteristics

Most countries across ASEAN have an active domestic alcohol beverage industry. Given a range of factors, including climate and consumption preferences, alcohol consumers across ASEAN predominantly consume beer and spirits products. However, as median incomes continue to rise across the region, an increasing proportion of consumers is diversifying to other beverages, including wine and ready-to-drink (RTD) beverages.[31]

Domestic producers account for a considerable majority share of alcohol market volumes across ASEAN. In particular, domestic brewers generally dominate local markets, in terms of total product volumes, whilst domestic distilled spirits production is also significant in larger ASEAN countries such as Thailand, Vietnam and Indonesia.[32] Whilst market volumes for beer are generally readily available, distilled spirits production is generally harder to account for.[33]

[31] Analysis of market trends as reported by the International Wine and Spirits Research (IWSR) organisation, June 2013.
[32] Measured in terms of thousands of 9 litre cases (000's 9L cases), which is the internationally recognised market volume measure.
[33] The IWSR often finds difficulty in accurately accounting for total domestic spirits production, particularly in Indonesia where there is limited detailed data to accurately quantify the size of the spirits market within ASEAN's most populous country.

Broad impact of domestic alcohol tax law on imported alcohol beverages

Levying fair and transparent alcohol taxes on imported alcohol beverages is one of the key challenges presently facing alcohol tax authorities. Governments seek to achieve two primary objectives through alcohol taxation. Firstly, taxation authorities seek to recover the negative impact of excessive/risky alcohol consumption on society (e.g. health issues associated with the misuse of alcohol) Secondly, excisable products often have a low price elasticity and, as such, developing countries have enacted alcohol taxes for revenue purposes. Regardless of consumption concerns, alcohol taxes have traditionally represented an important revenue base to governments.[34]

Imported alcohol beverages generally account for a relatively small proportion of overall alcohol tax market volumes across most ASEAN countries. Whilst being smaller in terms of the total size of the alcohol market, imported beer, distilled spirits and wine products generally have identical product characteristics to their domestically-produced competitor products. However, given production, transportation and associated costs, imported alcohol beverages generally have an import value (generally the Cost plus Insurance plus Freight (CIF) value) that is higher than the production value (generally the ex factory value) of similar domestic products.

A review of alcohol tax structures across ASEAN demonstrates that imported alcohol beverages are effectively levied with higher alcohol taxes than domestically produced products for a variety of reasons. These reasons include:

- *Ad valorem taxation:* higher import values result in a higher alcohol tax base value than like domestic alcohol beverages;
- *Product classification:* alcohol tax systems can be structured in a way that results in imported products being classified and treated differently to like domestic products; and
- *Different tax rates:* some countries, for example Indonesia, apply explicitly different alcohol tax rates for some imported and domestic alcohol beverage products.[35]

Such differentiation in the alcohol tax treatment of imported and domestic alcohol beverages raises key questions that have the potential to inhibit effective regional integration across ASEAN. ASEAN's development into an effectively coordinated and internationally competitive trading region cannot appropriately sustain the differential tax treatment of similar excisable products.

As Professor Sijbren Cnossen states:

[34] S. Cnossen, 'Economics and politics of excise taxation', Tax Notes International, International Tax and Investment Centre, Washington D.C., 2005

[35] Domestic taxation that results in a tax burden that is explicitly higher on imported products than on like and substitutable products would be unlikely to meet the 'National Treatment' provisions as per Article III of the *General Agreement on Tariffs and Trade 1994*, which is an annex to the *World Trade Organization (WTO) Agreement 1994*.

> *"While competition is the allocating mechanism in an economic community, tax coordination is the corollary in so far as it aims at ensuring that equal conditions for competitors are not distorted by discriminatory tax systems."*[36]

The following summary of ASEAN tax structures highlights the challenges currently facing ASEAN policy makers in coordinating excise taxation arrangements.

5.2.2 Alcohol tax systems across ASEAN

Internationally, alcohol beverages are levied an excise as a means to either discourage consumption, or more specifically, to recover the costs of risky consumption on society. From this perspective, policy makers perceive excise as a tool in generating a social benefit via an economic measure. Alcohol is a key consumable good where policy makers deliberately attempt to influence consumption patterns to minimise adverse health effects.

In a World Bank policy research working paper, John F. Due remarks that excises that are designed to discourage consumption "are deliberately discriminatory against users of the products."[37] Due is quite explicit in his arguments that traditional excises on consumable products with perceived health risks are intended to 'penalise' or 'discriminate' against consumers, as a means of controlling the community's consumption and raising revenue to meet external adverse impacts from consumption. With this clear policy objective in mind, alcohol taxation should remain simple, with alcohol content the primary factor in determining the social cost of the product to society.

As indicated in the Phase 1 survey, ASEAN member countries currently utilise a broad range of alcohol tax structures. Several of these tax systems are highly complex, which appears to indicate that alcohol taxation seeks to achieve a broad range of objectives including raising revenue, protecting domestic industry and influencing consumption patterns. In general, developing countries have a higher reliance on narrow-based taxes, such as excise and customs duties, given a smaller capacity to raise broad-based tax revenue through means such as corporate and personal income tax. This is demonstrated in Table 18, which shows that ASEAN's most developed economy, Singapore, is considerably less reliant on excise and customs duty revenue than developing and less-developed countries, eg Thailand and Cambodia.

Table 18: Government revenue from customs and excise duties

Level of economic development	ASEAN Country	Proportion of government revenue from customs and excise duties
Developed economy	Singapore	17.3 per cent
Developing economy	Thailand	33.9 per cent
Less-developed economy	Cambodia	46.3 per cent

Source: Obradovic, 2012 sourcing IMF 2008 data, Cnossen 2011

[36] S.Cnossen, 'Reform and Coordination of indirect taxes in the ASEAN free trade area', *Asia-Pacific Tax Forum*, Maastricht, 2011
[37] J. Due, 'Excise Taxes', *Policy Research Working Paper 1251*, The World Bank Public Economics Division, 1994, p. 3

Whilst the data above accounts for customs and excise duties on all excisable products, alcohol taxation is levied on alcohol beverages in each ASEAN market. As such, alcohol taxation is influenced by a wide range of policy priorities across ASEAN.

Alcohol taxation structures across ASEAN

This section provides an overview of how each ASEAN country levies excise/alcohol taxes. Each ASEAN country is listed in alphabetical order.

A. Brunei Darussalam

As a predominantly Muslim country with a small population, the Kingdom of Brunei Darussalam has a limited overall alcohol market. Excises are levied on alcohol beverages in both a unitary and a specific (per proof litre) method. As outlined in Figure 5, higher rates are levied on beverage products that are likely to have a higher production or import value.

Figure 5: Graphical outline of Brunei Darussalam alcohol tax structure (as at 9 May 2007)

Product Category	Excise Duty (as at 9 May 2007)
Beer	BND 30.00 per Decilitre
Wine products	
Sparkling wine	BND 120.00 per Decilitre
Other wine products ≤ 15° abv	BND 55.00 per Decilitre
Other wine products > 15° abv	BND 90.00 per Decilitre
Other fermented beverages	
Cider, perry, shandy, other (including mead)	BND 30.00 per Decilitre
Sake (rice wine), toddy	BND 90.00 per Decilitre
Distilled spirits	
Brandy, whisky, rum and tafia, gin and geneva, vodka, liqueurs, cordials and bitters	BND 250.00 per Proof Decilitre
Samsu, arrack and pineapple spirit ≤ 40° abv	BND 90.00 per Decilitre
Samsu, arrack and pineapple spirit > 40° abv; others	BND 120.00 per Proof Decilitre



Range of different unitary and specific rates by beverage sub-category

Sources: *Excise Duty - Excise Order 2006 (S 40/06); Excise Duties Order 2007;* National Tax Research Center, *Taxation of Alcohol Products in ASEAN Countries*, March-April 2009 (abstract available at http://serp-p.pids.gov.ph/serp-p/details.php?pid=4906&param=, accessed 19 June 2012)

Brunei Darussalam does not levy Customs Duties on imported alcohol beverages. As such, domestic excise is the primary taxation method for the whole alcohol market.

B. Cambodia

By regional standards, Cambodia levies a comparatively low ad valorem excise rate on all alcohol beverage categories. Given that market volumes are dominated by beer, a higher ad valorem excise (known as the 'Specific Tax on Certain Merchandises and Services') of 25 per cent applies to beer. In contrast, the ad valorem excise rate on wine and spirits products is a considerably lower 10 per cent.

Figure 6: Graphical outline of Cambodia alcohol tax structure (as at October 2010??)

Product Category	Specific Tax on Certain Merchandises and Services (Excise)
Beer *(all beer)*	25%
Wine *(all wine)*	10%
Spirits *(all spirits)*	10%

Comparatively low ad valorem alcohol taxes be regional comparison

Sources: *Specific Tax on Certain Merchandises and Services: General Department of Taxation of Ministry of Economy and Finance, Specific Tax on Certain Merchandises and Services, available at <http://www.tax.gov.kh/en/bgoods.php>, accessed 16 October 2012*

Key points:

For domestic beverages, Cambodia's excise tax base is '65 per cent of the invoice value to customers', indicating that the ad valorem tax base is calculated towards the retail point of the supply chain; and

Cambodia is currently considering reform to its excise taxation regime. The AEC 2015 reform period could provide a useful opportunity for Cambodia to ensure that domestic alcohol tax reform is consistent with the principles associated with regional economic integration.

C. Indonesia

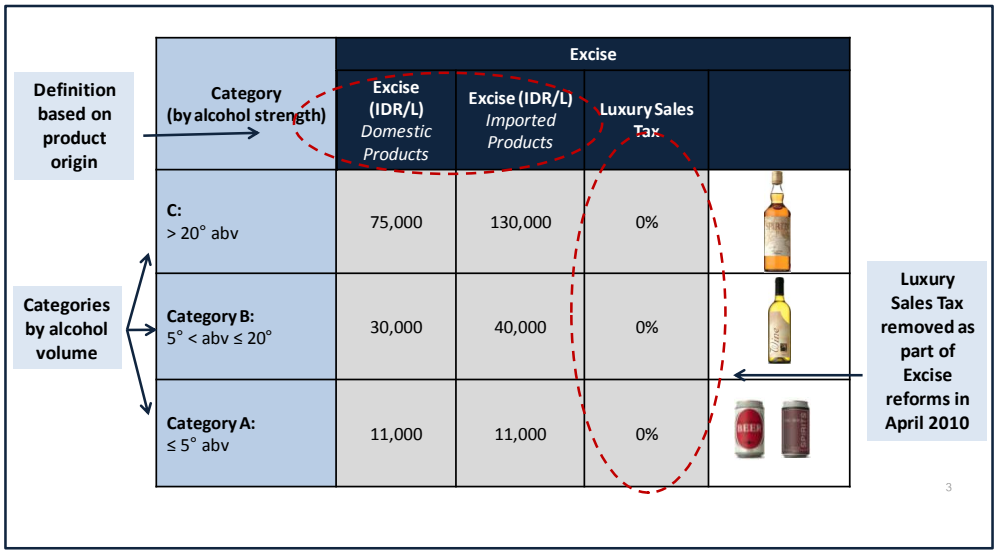
Indonesia has one of the simplest alcohol tax structures of the ten ASEAN countries. Often praised by international taxation experts, Indonesia's excise structure does not distinguish between alcohol beverage categories. Indonesia utilises a vertical approach, in which three alcohol taxation categories are solely determined according to the alcohol strength of the product. As such, there is no reference to product characteristics within the alcohol tax system and excise authorities are not faced with product classification issues when determining the appropriate product category.

As a predominantly Muslim country, a majority of Indonesia's population chooses to abstain from alcohol consumption. Despite one of the lowest per capita alcohol consumption rates in ASEAN, Indonesia does sustain a domestic alcohol industry that produces local and international beer varieties. Indonesia also sustains a domestic spirits industry that accounts for a majority of the alcohol market in terms of total litres of alcohol. However, as outlined earlier, it is difficult to accurately account for domestic spirits market volumes.[38]

[38] IWSR, op cit, Indonesia Report, 2013.

As outlined in Figure 7, Indonesia levies unitary (per litre) excise rates in three categories (A, B and C) according to alcohol strength. This simple design ensures tax equivalence between alcohol products with similar alcohol strengths (e.g. beer and RTD products, wine and liqueur products). However, problematically, the structure also explicitly differentiates between domestic products and imported products.

Figure 7: Graphical outline of Indonesia alcohol tax structure (as at April 2010)



Sources: *Excise Duty: Ministry of Finance Notification 62/PMK 11/2010*

Key points:

Indonesia officially endeavours to restrict the supply of alcohol in the market, with the alcohol tax structure accompanied by a range of regulatory restrictions. In particular, quotas apply to restrict importation of products in all three beverage categories. Furthermore, off-premise sales of Category B and Category C beverages are restricted across much of Indonesia.

When viewed in a volumetric (per LPA) perspective, all Category A and imported Category C beverages are levied with the highest effective excise rate. Publicly available data suggests that the high excise rate and regulatory restrictions on imported Category C beverages is resulting in over 90 per cent of total market volumes entering Indonesia via smuggled or counterfeit channels; and

the existence of different excise rates for domestic and imported alcohol beverages is unlikely to be compliant with Indonesia's international trade law obligations. A higher excise rate for imported Category B and Category C alcohol beverages affords protection to domestic products, thus calling into question Indonesia's compliance with the WTO's National Treatment provisions, enshrined within Article III of the GATT.

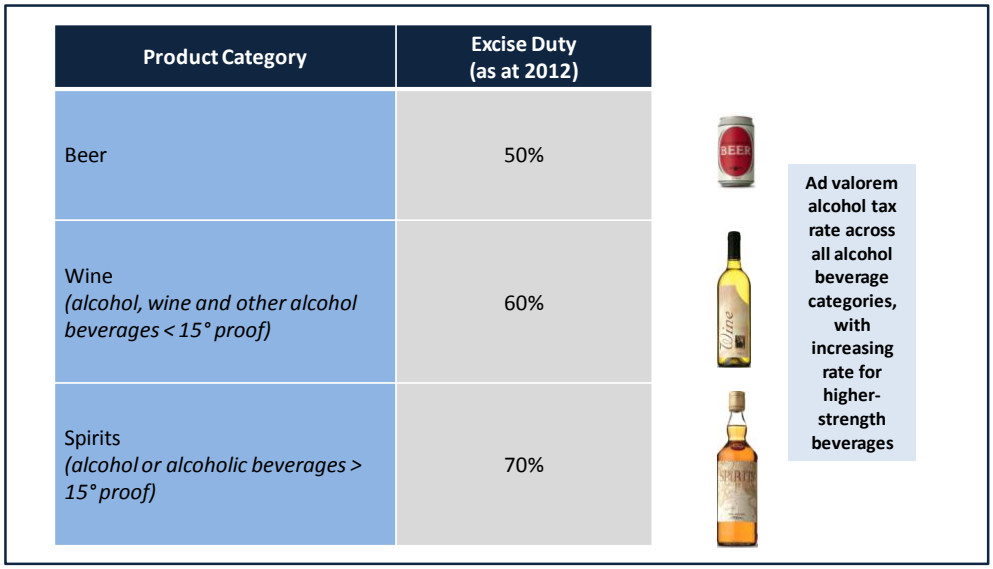
Indonesia's alcohol excise system is generally well designed. However, its effectiveness is inhibited by the above-mentioned issues. Features that enshrine differential treatment to like domestic and

imported products contradict the principles of economic integration. Indonesia's proportionately small alcohol market would benefit from further simplification, which would build on the positive reforms from April 2010.

D. Laos

Like other less-developed ASEAN countries, Laos utilises ad valorem excises for all categories of alcohol beverages. The Laos alcohol tax structure is relatively simple, with ad valorem rates for alcohol beverages starting at a rate of 50 per cent for lower-strength beer products. These rates increase progressively to 60 per cent for wine products and 70 per cent for distilled spirits beverages. The Laos alcohol tax structure is outlined in Figure 8.

Figure 8: Graphical outline of the Laos alcohol tax structure



Source: *Excise Duty: Presidential Degree on Promulgation of the Tax Law No. 46/OP, May 2005* (UNDP Draft Translation of March 2006); Rob Preece, 'Excise taxation of key commodities across South East Asia: a comparative analysis ahead of the ASEAN Economic Community in 2015' *World Customs Journal* 6(1) (2012).

Key points:

Whilst the Laos alcohol tax system is relatively simple, the ad valorem excise rates applied are high by regional standards. This is particularly significant, given that Laos is a less-developed economy by regional standards; and

High excise rates for beer, wine and spirits beverages in comparison to neighbouring countries could incentivise no tax-paid activities; such as smuggling and counterfeit production.

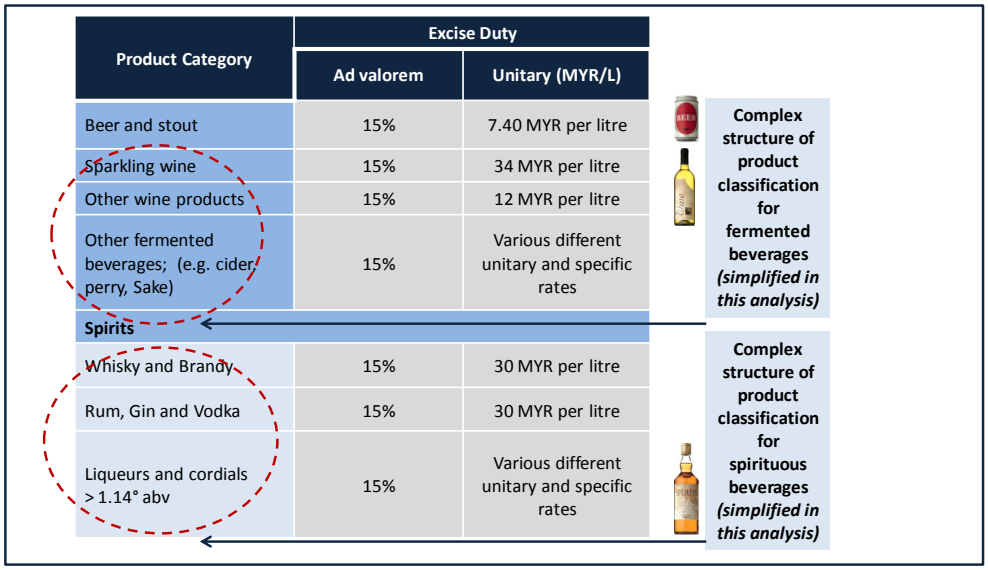
E. Malaysia

Malaysia utilises one of the most complex alcohol tax structures across ASEAN. With numerous alcohol tax categories across beer, wine and spirits, Malaysia's taxation authorities face higher

complexity in terms of product categorization and tax treatment. Once categories, alcohol beverages in Malaysia could be liable for either a unitary or a specific excise rate. Furthermore, all alcohol beverages that enter the Malaysian alcohol market through official channels in Malaysia are liable for an additional ad valorem excise component of 15 per cent.

The cumulative impact of this complexity, and the comparatively high excise rates, results in high alcohol tax burdens from a regional perspective. Given the multiple product categories and rates, Figure 9 provides a simplified overview of key products within the Malaysia alcohol tax system.

Figure 9: Graphical outline of Malaysia's alcohol tax structure (at at 2006)



Source: *Excise Duty:* Malaysian Government Budget 2006 (Appendix A1)*; Excise Duties Order 1991* (Schedule);,

Key points:
Like Indonesia, Malaysia is a majority Muslim country and the policy setting for alcohol beverages is largely designed to restrict overall consumption;

However, like Indonesia; Malaysia also has a domestic alcohol industry, with a particular focus on the beer industry. With relatively high excise rates across key product classifications in each beverage category, industry submits that Malaysia faces significant levels of non-tax paid activity for beer, wine and spirits categories; and

One of the greatest levels of complexity is associated with the 'hybrid' or 'mixed' nature of the alcohol tax system. This results in the unique situation where products are levied with category-specific unitary or specific excise rates, whilst each product is also levied with a flat 15 per cent ad valorem excise component. This structure adds additional complexity by creating a valuation task for excise authorities in addition to product classification requirements.

In addition to the product categories for traditional alcohol beverages, Malaysia also has a category for lower-quality 'compounded hard liquor' products. These distilled spirits are subject to a

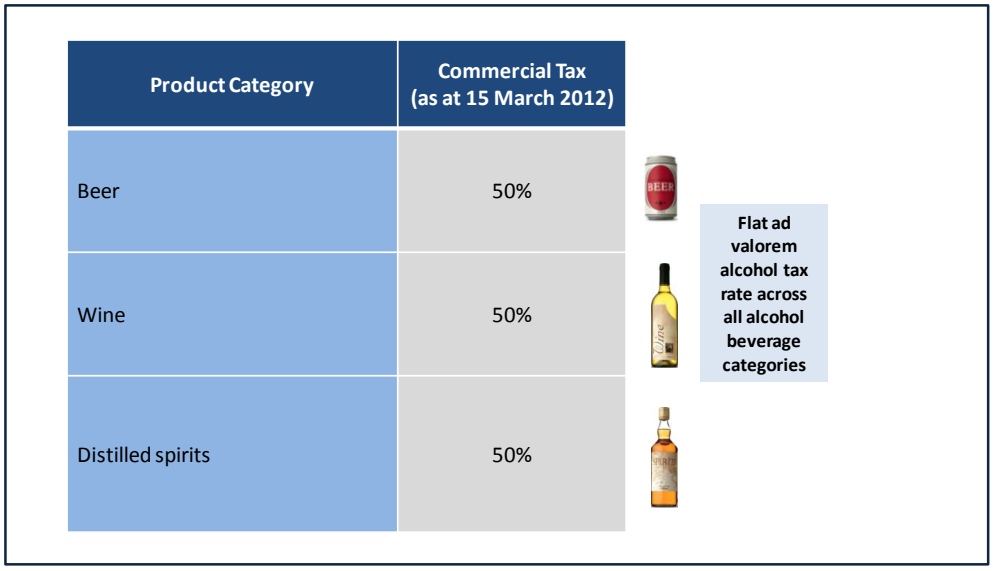
separate very low rate of 22.50MYR per LPA, and utilise the HS tariff classification HS 2207.10, for bulk 'undenatured ethyl alcohol >80° a.b.v.'. It is understood that the process of manufacturing basic distilled spirits beverages from bulk industrial alcohol is permitted as a substitute to the consumption of poor or dangerous quality counterfeit spirits products.[39]

Regional integration poses several challenges for alcohol taxation and regulation in Malaysia, which as traditionally excluded alcohol beverages from bilateral and regional trade agreements. This project offers a unique opportunity for Malaysia to participate in a regional framework, whilst still maintaining its right to administer its own alcohol tax system.

F. Myanmar

The recent opening up of the Myanmar economy has led to renewed interest in the country's alcohol tax system at an ASEAN regional level. Myanmar currently levies a Commercial Tax on alcohol beverage products, at a flat ad valorem rate of 50 per cent.

Figure 10: Graphical outline of Myanmar's alcohol tax structure (as a 15 March 2012)



Source: Commercial Tax Law, Myanmar

Key points:

- Myanmar's re-emergence as a regional economy coincides conveniently with efforts by ASEAN members to enhance integration and cooperation; and
- The Myanmar Government is currently working with the international community to further develop its tax system. Designed appropriately, Myanmar's alcohol tax system can help to achieve the country's health, social and economic policy objectives. Importantly, Myanmar would be well-placed to capitalise on opportunities associated with regional value chains in terms of alcohol production, importation and supply.

[39] The excise rate of 22.50 per LPA for products originating from bulk alcohol classified under HS 2207.10 is equivalent to a unitary rate of 9MYR per litre. This is considerably lower than the rate of 30MYR per litre applying to distilled spirits beverages.

G. Philippines

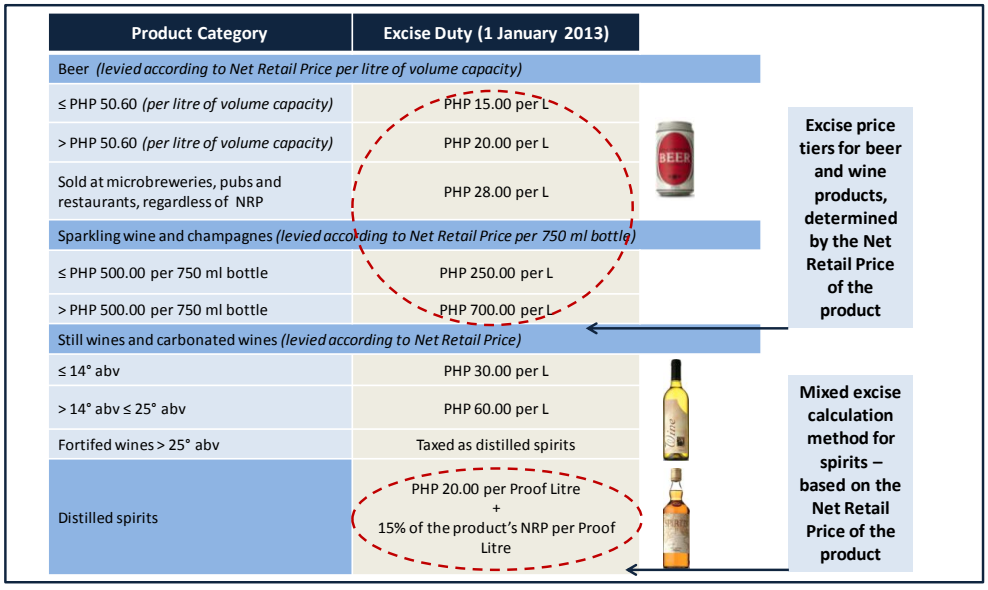
As Southeast Asia's second most populous country, the Philippines has long been an important alcohol market within ASEAN. With a large production base and a broad network of domestic and international raw material suppliers, the Philippines is a key country for alcohol production and distribution.

Significantly, the Philippines is the country that most recently reformed its alcohol taxation system following the decision handed down by the WTO. In response to a claim lodged by the United States and the European Union, the WTO found the Philippines' system for the taxation of spirits to be in breach of the National Treatment principle, enshrined in the *GATT 1994*. The ensuing reforms saw the Philippines remove the distinction between traditional, internationally recognised distilled spirits and a specific category of spirits produced from a select variety of (local) ingredients.

The Philippines presently utilises an alcohol tax system based on the Net Retail Price (NRP) of the beverage category. Figure 11 provides a graphical representation of the alcohol tax system, and demonstrates that NRP underpins the taxation of beer, wine and spirits products. NRP plays a key role in the alcohol tax system through:

- Setting price tiers to determine the unitary tax rate for beer and wine products; and
- Providing a tax base, as a component of the 'NRP per proof litre' calculation for distilled spirits products.

Figure 11: Graphical outline of the Philippines' alcohol tax structure (as at 1 January 2013)



Source: *Excise Duty: Revenue Regulations No. 17-2012*

Key points:

- Whilst the alcohol tax changes of December 2012 greatly simplified one aspect of Philippines' alcohol tax system (namely spirits), the alcohol tax system is still one of ASEAN's most complex;

- The concept of NRP raises numerous questions around transparency and commercial adaptability. Determining a product's NRP requires the formal involvement of Philippine's alcohol tax authorities. In particular, the NRP system requires a price survey of retail prices (in particular in Metro Manila), to enable the calculation of a price net of taxes paid; and
- The effective pre-determining of retail prices to determine tax bases and tax thresholds is counter-productive to key taxation principles of equity, efficiency and simplicity. The Philippines remains the only country in ASEAN to utilise a retail price methodology.

The transition and implementation of the new Philippines alcohol tax system raised several tax administration issues. Of particular concern was the potential for 'double taxation' within the alcohol supply chain, as imports of bulk raw spirit were potentially liable for the payment of the two excise components upon leaving the wharf. Traditionally, excise has only been levied once on products manufactured in the Philippines, and as such excise has traditionally been levied at the point of bulk importation – and not on the finished products of goods produced from imported bulk alcohol.

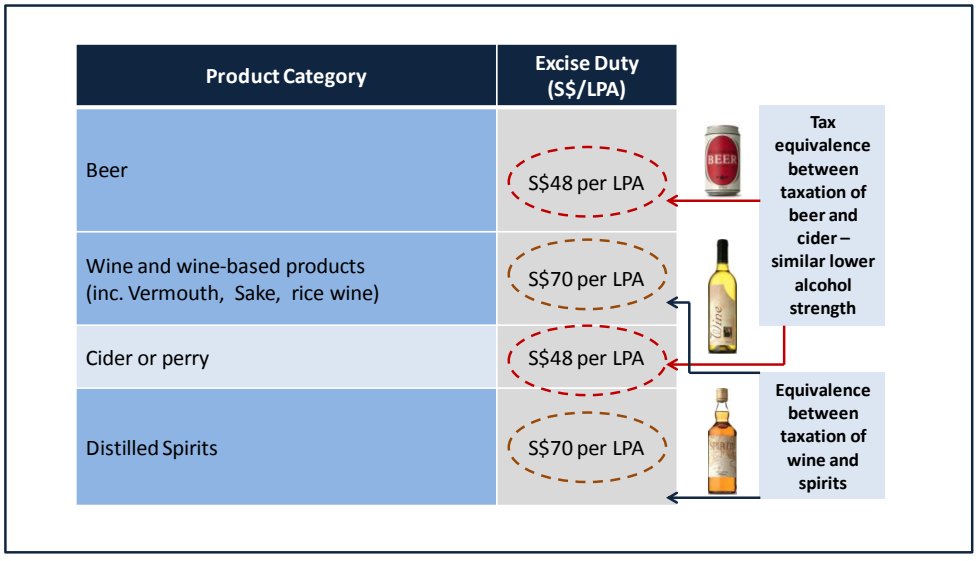
The regional value chain has been important to the Philippines over the years, and regional integration in the context of AEC 2015 has the potential to enhance the Philippines' effectiveness as a regional hub for alcohol production.

H. Singapore

Despite being a relatively small domestic alcohol market, Singapore is an important 'hub' in terms of the alcohol industry across ASEAN. With its liberal investment environment, strategic geographical location and excellent infrastructure, Singapore is a regional trading and distribution point for many major alcohol importers.

In terms of domestic alcohol taxation, Singapore is often presented by taxation experts as an ideal case study. In spite of its high excise rates, Singapore levies a simple and transparent alcohol excise, purely utilising specific (per LPA) rates. Figure 12 provides a graphical representation of Singapore's alcohol tax structure.

Figure 12: Graphical outline of Singapore's alcohol tax structure (as at 1 December 2011)



Source: *Excise Duty: Singapore Trade Classification, Customs and Excise Duties 2012*

Key points:

- Singapore's alcohol tax system reflects simplicity and transparency, whilst also providing tax equivalence between products with similar alcohol volumes. As highlighted above, excise rates are levied to ensure that beer and cider/perry products with similar a.b.v. strengths pay the same specific rate;
- Given the uniform excise rates for products within each key beverage category, product classification is of lesser importance, with the exception of spirits-based RTD beverages.

Singapore's role in the ASEAN alcohol supply chain is primarily as a gateway for international commerce to the region. As such, it is important that the tax and regulatory environment in Singapore remains conducive to open trade in terms of importation into Singapore, and ready distribution into the domestic markets of Southeast Asia.

I. Thailand

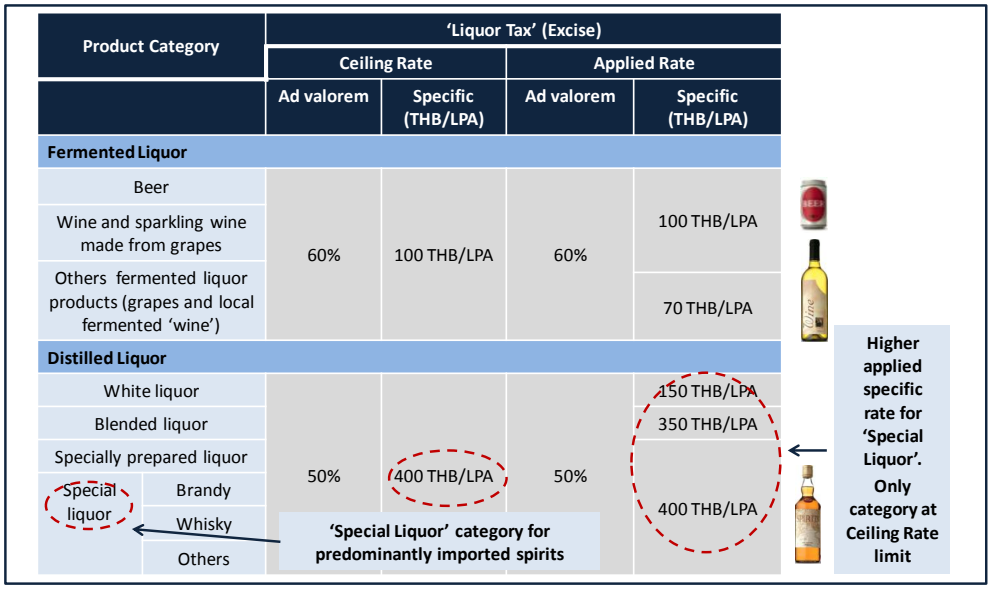
Thailand is another country that can arguably lay claim to ASEAN's most complex and cumbersome alcohol tax system. Thailand's 'Liquor Tax' utilises a range of measures that, when combined, result in substantially different tax rates on similar products within the key beverage categories of beer, wine and spirits.

Alcohol taxation in Thailand utilises a 'mixed' specific (per LPA) and ad valorem system, in which products are levied a specific or an ad valorem excise rate depending upon which approach results in the highest total excise duty collection. In addition to this key feature, alcohol taxation in Thailand also contains the following features:

- *Product tax categories:* similar products within a beverage category (e.g. imported spirits products) are categorised in different tax categories to like products (e.g. domestic blended spirits). These categories have different applied rates;
- *Ceiling/applied rates:* Parliament mandates maximum rate 'ceilings', within which policy makers can apply certain rates;
- *Headline/effective rates:* whilst the Thai alcohol tax system reports ad valorem rates, the actual rate applied is effectively much higher given a circular calculation method that includes excise paid in the ad valorem tax base calculation; and
- Set ex-factory values: The Thai Government, via the Royal Thai Excise Department, mandates the ad valorem tax base for domestically-produced beverage products.

The complexity of Thailand's alcohol tax system is graphically outlined in Figure 13.

Figure 13: Graphical outline of Thailand's alcohol tax structure (as at 1 December 2012)



Source: *Excise Duty: Ministerial Regulations Prescribing Types of Liquor and Rates of Liquor Tax BE 2546 (2003); Ministerial Regulations Prescribing Liquor and Rates of Liquor Tax (No. 2) BE 2548 (2005); Ministerial Regulations Prescribing Types of Liquor and Rates of Liquor Tax (No. 3) BE 2550 (2007); Ministerial Regulations Prescribing Types of Liquor and Rates of Liquor Tax (No. 4) BE 2552 (2009);* Richupan, S., *Alcohol Products Taxation: International Experiences and Selected Practices in Asia*, 7 February 2005; *Ministerial Regulations Prescribing Types of Liquor and Rates of Liquor Tax (No. 5) BE 2555 (2012).*

Key points:

- Whilst not explicitly defining domestic or imported products, the complexity of Thailand's alcohol tax system effectively results in separate treatment for imported products. This is particularly the case with spirits, where the existence of the 'Special Distilled Ethyl Alcohol' (Special Liquor) category quarantines most alcohol imports into a single category with a higher applied specific Liquor Tax rate;
- Furthermore, the mixed specific and ad valorem system results in a considerable proportion of imported spirits products being levied with the higher ad valorem Liquor Tax rate, whilst like domestic products are levied with the lower specific rate;
- The complex threshold between the lower specific rate and the higher ad valorem rate is amplified by the use of the complex circular formula for calculating the Liquor Tax payable. This formula includes Liquor Tax to be paid into the tax base, therefore dramatically increasing the final tax payable.

Policy makers in Thailand continue to grapple with the impact of regional trade liberalisation, particularly through Thailand's network of FTAs, on ad valorem tax bases. Thailand currently utilises a system of mandated set ex-factory prices to determine the tax base on domestic alcohol products, whilst utilising CIF plus customs duty to determine the tax base for imports. Recent years have seen draft proposals to increase tax bases by shifting the effective taxing point down the supply chain, or even by re-constituting 'most favoured nation' (MFN) customs duty rates into the tax base calculation for imported beverages.

It is important that regional integration through the AEC 2015 process ensures a smooth and transparent enmeshment into regional supply chains, without winding back the benefits of greater market access into and out of Thailand.

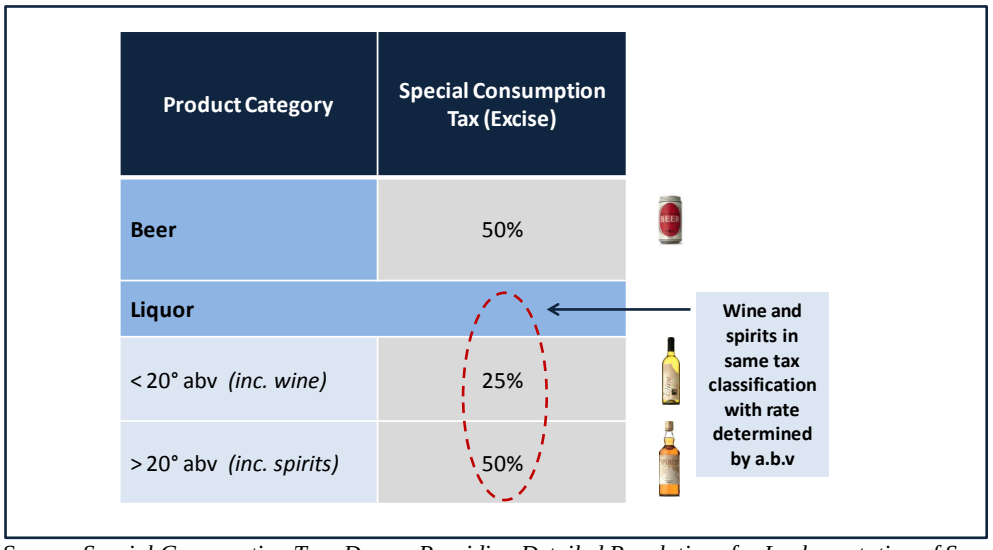
J. Vietnam

Like several other countries throughout ASEAN, Vietnam utilises a simple ad valorem structure for its 'Special Consumption Tax' (SCT) on alcohol beverages. Vietnam effectively levies two ad valorem SCT rates on alcohol beverages, with a rate of 50 per cent for beer products and for all alcohol beverages (defined as 'Liquor') with an alcohol strength over 20° a.b.v. There is also a lower ad valorem rate of 25 per cent for all alcohol beverages (other than beer) with an a.b.v that is lower than 20° a.b.v.

Vietnam simplified its alcohol tax structure in 2010, to coincide with its accession to the WTO. Through this process, Vietnam ensured the application of a single SCT rate for all spirits products over 20° a.b.v., therefore ensuring that multiple tax rates did not apply to similar beverage categories in the full-strength spirits category.

As a large and fast-growing alcohol beverage market, Vietnam is also an emerging hub for the production and distribution of alcohol beverages within ASEAN. With the cumulative impact of ad valorem Customs Duties impacting the tax base for the ad valorem SCT, Vietnam levies comparatively low alcohol taxes on alcohol beverages in comparison to less-developed neighbouring countries, such as Cambodia and Laos. As such, leakage from the official tax-paid market into non-tax paid channels via cross-border smuggling is an issue. Figure 14 contains a graphical representation of Vietnam's alcohol tax system.

Figure 14: Graphical outline of Vietnam's alcohol tax structure (as at 1 January 2013)



Source: *Special Consumption Tax: Decree Providing Detailed Regulations for Implementation of Some Articles of the Law on Special Consumption Tax 2009/ND-CP (Draft)* (English translation); Vietnam News and Information Portal, *Provisions on Special Consumption Tax*, available at http://en.www.info.vn/life-and-laws/more-laws/9917-provisions-on-special-consumption-tax-.html, 10 August 2010. Special consumption tax rates for 2013 reported by PriceWaterhouseCoopers Vietnam, available at http://www.pwc.com/vn/en/publications/2013/pwc_vietnam_pocket_tax_book_2013.pdf

Key points:

- Vietnam's alcohol market is dominated by domestic beer production, which, despite its comparatively high SCT rate, enjoys the protection of a high MFN ad valorem Customs Duty rate of 35%;
- Vietnam's considerable domestic spirits industry also benefits from a considerable MFN ad valorem Customs Duty rate of 45%. This rate has decreased in recent years as part of Vietnam's WTO accession commitments;[40]
- Ongoing SCT reform should also investigate the use of a specific tax on alcohol beverages. Given the direct impact of ad valorem Customs Duties on the SCT tax base, the current system exposes the Vietnam alcohol tax system to the risk of under-invoicing and price manipulation by importers and distributors. Such problems do not occur in specific tax systems, where price is not a factor in determining a product's alcohol tax liability.

Regional integration through the AEC 2015 process will play a role in shaping Vietnam's role as a potential hub for the production and distribution of alcohol beverages in ASEAN. With its wholly ad valorem alcohol tax system, regional trade enhancements may also impact the alcohol tax system through the impact of administrative savings on product tax bases (e.g. savings to importers through streamlined importation processes).

Administrative enhancements though the AEC 2015 process also provide an opportunity for Vietnam to consider structural enhancements to its alcohol tax system. Such reforms can minimise revenue leakage associated with cross-border smuggling and the 'trading down' of consumers to lower-taxed, and lower-quality beverage products.

5.2.3 Issues of complexity

There are several issues associated with complexity that have a considerable impact on the current excise taxation of alcohol beverages across ASEAN. With the development of alcohol tax systems shaped by a multitude of factors over time, the alcohol tax systems outlined previously reflect a broad range of policy factors within individual countries.

As briefly outlined earlier, complexity in an alcohol tax system is often directly associated with product classification. The greater number of product categories, the greater the degree of burden that is placed on policy makers, regulators and industry. This is particularly the case when multiple product classifications result in the levying of different excise rates on similar alcohol beverages within a certain category (e.g. two different types of wine or two different types of spirits). Key product complexity issues include:

- Product categorisation methods; and in particular
- Differentiation between domestic and imported alcohol beverage products

[40] WTO Vietnam Accession Commitment Schedule, *MFN tariff reduction commitments*

Product categorisation methods

International best practice recognises that alcohol should be taxed according to its alcohol content (which is explained further in Section 5.2.4). Under such a scenario, the alcohol content of a product is the sole determining factor when setting an excise rate. As outlined in Chapter 2, the WCO Harmonised System (HS) Tariff classifies alcohol beverages at the four digit heading level into five specific categories:

- Beer HS 2203;
- Wine products (grape wine) HS 2204;
- Vermouth and flavoured wines HS 2205;
- Cider and other fermented beverages HS 2206; and
- Distilled spirits (for human consumption) HS 2208.

Whilst the HS Tariff provides one possible framework for the classification of alcohol beverages for excise purposes, it is rarely utilised in alcohol tax structures with the exception of Malaysia. Countries across ASEAN choose to classify alcohol beverages in a range of ways, including:

- *By alcohol content:* as demonstrated in Indonesia, where the excise structure makes no reference to product categories (e.g. wine) or product sub-categories (e.g. sparkling wine);
- *By product characteristic:* as demonstrated in Thailand, where individual spirits product categories (as defined by the HS at the six digit sub heading level) are classified a 'Special Liquor' in the alcohol tax system;
- *By product price:* as demonstrated in the Philippines, where the NRP of a product provides a threshold point in setting different specific tax rates for beer and wine products; and
- *Though combined means:* several countries utilise a combination of product classification measures to achieve a policy objective. For example, whilst Singapore sets its excise rate according to product characteristics, it levies a lower excise rate on cider products to ensure that it is taxed equivalently to beer (which has a similar alcohol content).

Differentiation between domestic and imported products

Complexity within the alcohol tax system can be particularly problematic if it results in the levying of a higher excise rate on imported products than on like domestic products. Across ASEAN there are examples of both explicit differentiation and implicit differentiation in the excise tax treatment of imported products to like domestic products. Key examples include:

- *Explicit differentiation:* as demonstrated in Indonesia, where the excise structure results in separate higher rates for imported Category B and Category C beverages; and
- *Implicit differentiation:* as demonstrated in Thailand, where the 'Special Liquor' spirits category is levied a higher applied specific excise rate than the rate applied to local 'White Liquor' and 'Blended Liquor' products.

Whilst alcohol tax systems across ASEAN (with the exception of Indonesia) do not explicitly reference 'domestic/local' or 'imported' products, the existence of implicit differentiation has the

potential to give rise to international trade law concerns. In recent years, several ASEAN countries have amended their alcohol tax structure to meet their WTO commitments of ensuring adherence to the National Treatment (non-discrimination) principle. Key examples include:

- *Philippines (2012):* following a WTO trade dispute, the Philippines removed references to specific product characteristics, and price-based excise tiers in its alcohol tax legislation. The product characteristics in the old law ensured that a majority of local production was levied a considerably lower excise rate; and
- *Vietnam (2010):* to meet its WTO accession commitments, Vietnam removed an excise threshold of 40° a.b.v., which provided for a higher excise rate for spirits products with a higher a.b.v.

Implicit differentiation can take many forms. In the case of the Philippines pre-December 2012, specific locally-produced products were afforded a particular taxation category, whilst the rest of the spirits market was defined as 'other spirits'. In the case of present-day Thailand, it is imported spirit products (e.g. whisky, vodka and some Asian-origin spirits) that are allocated the specific product category of 'Special Liquor'. Conversely, the bulk of the rest of the (mostly domestic) spirits market is categorised under general 'White Liquor' and 'Blended Liquor' categories.

Unique product classifications, such as those outlined above, have the potential to inhibit the effective integration of regional supply chains and the trade of alcohol beverages throughout ASEAN. Such complexity can be difficult for investors outside of Thailand to manage and has the potential to inhibit the growth of legitimate tax-paid markets at the expense of non-tax paid goods, including smuggled and counterfeit product.

5.2.4 Alcohol taxation methods

As outlined previously, countries apply a range of specific/volumetric, ad valorem and mixed/hybrid alcohol tax systems across ASEAN. The summary of individual alcohol excise structures in each country demonstrates the complexity associated with the regional production and trade of alcohol beverages.

The use of specific alcohol taxation

Several countries across ASEAN utilise specific excise on alcohol. Specific excise is almost universally recognised as the preferred method of alcohol taxation, as alcohol content, and the rate are the only determining factors in the tax burden of a particular product. Specific or unitary taxes are utilised in Singapore, Indonesia and Brunei Darussalam.

Global best-practice

Specific taxation is applied internationally as a world's best-practice approach. The WHO recognises a non-discriminatory specific tax system as world's best-practice as such a system correlates the level of alcohol in the product to the tax payable. A specific tax system is a feature of industrialised economies, with twenty-eight of the thirty OECD economies currently employing such a system.

Specific taxation underpins alcohol taxation across the European Union

EU member countries are required to ensure that their domestic tax laws adhere to the requirement that alcohol beverages are levied under a volumetric excise system. Whilst individual EU countries retain the right to set different excise rates to one another, EU membership carries with it a requirement to adopt the volumetric alcohol tax methodology.

The principles underpinned by a common tax methodology are features of the EU's modern and transparent tax and revenue policy systems. The principles are underpinned by *Directive 92/84 EEC* and *Directive 92/83/EEC*, demonstrating that specific taxation is not only a benchmark, but a requirement in this comprehensive economic community:

> *"the most appropriate basis for levying duty on ethyl alcohol is the volume of pure alcohol"*
> EU Directive 92/84/EEC of 19 October 1992

The use of ad valorem alcohol taxation

Ad valorem alcohol taxation is commonplace in less-developed economies with more limited taxation infrastructure and a greater reliance on excises for general government revenue purposes. Whilst ad valorem taxes can be simpler to design and administer, they also create additional areas of complexity associated with the need for producers and importers to declare product values.

Incentive for price manipulation

One key disadvantage with ad valorem taxation is that the linkage between product value and the excise tax burden creates a financial incentive for producers or importers to 'under-invoice' the value of the product to reduce the size of the ad valorem tax base. Such price manipulation cascades through the supply chain and results in a reduction not only in the tax base for excise purposes, but also the tax base for other indirect taxes applied to the goods, such as VAT/GST.

Recent shift away from ad valorem taxation of alcohol

One of the most significant reforms to alcohol taxation in ASEAN in recent years was the April 2010 reform to alcohol taxation in Indonesia. In addition to rationalising the number of taxation categories, Indonesia also removed the ad valorem 'luxury sales tax' from all alcohol beverages. As such, this removed price as a major factor in the application of excise in Indonesia. Furthermore, Indonesia also shifted from ad valorem to unitary Customs duties for alcohol beverages, removing the need for importers to declare an import value for taxation purposes.[41]

Whilst not all recent alcohol tax reforms have resulted in the removal of all ad valorem taxation (such as the December 2012 reforms in the Philippines), reform initiatives such as the AEC 2015 integration project provide an opportunity to reform excise taxation in a manner that lessens the ability to manipulate price values throughout the ASEAN value chain.

[41] Customs Government Notification 82/PMK 11/2010

The use of mixed/hybrid alcohol taxation

Mixed or hybrid excise systems are arguably the most complex, as they impose a dual excise liability on producers and importers. Whilst a mixed alcohol taxation system includes some of the benefits attributed to a specific taxation system, the existence of an additional ad valorem component can result in lower transparency and greater uncertainty for government and industry.

Whilst a mixed or hybrid system can result in an effective excise 'floor' (minimum amount of excise to be paid), the role of a product's value in determining its treatment under the mixed/hybrid approach can create a considerable degree of uncertainty. For example, in Thailand, producers and importers are levied the greater of the excise burden resulting from an ad valorem calculation and from a specific calculation. As such, product value is an important threshold in determining the calculation applied. This adds complexity and has the potential to incentivise further price manipulation to lessen the tax burden.

Furthermore, recent reforms to the taxation of distilled spirits in the Philippines created a degree of uncertainty within industry regarding the correct tax treatment for spirits under a dual semi ad valorem (percentage of NRP per proof litre) and per-proof litre approach.

DISCUSSION QUESTION
CAN REPLACING AD VALOREM EXCISE TAXATION WITH SPECIFIC TAXATION HELP TO IMPROVE THE STABILITY OF YOUR ALCOHOL TAX SYSTEM?

5.2.5 Administration issues

Alcohol beverages across ASEAN face similar excise administration issues to other excisable products. A key focus on issues of administration is included in Chapter 4. There are, however, some key administrative issues of particular relevance to alcohol beverages, including:

- Accurately determining ad valorem excise tax bases; and
- Avoiding double-taxation within the supply chain.

Accurately determining ad valorem excise tax bases

A comprehensive overview of issues associated with excise tax bases is included in Chapter 3. As ASEAN looks for ways to integrate its regional economy, producers and importers will require greater flexibility and transparency in cross-border transactions. As such, the most common and relevant taxing point, at the point of Customs, is the accepted international norm for determining a Customs value. With this in mind, excise authorities across ASEAN generally calculate ad valorem excises according to the value of the good once it leaves the Customs port, inclusive of Customs Duty paid.

However, one key issues of particular relevance to alcohol beverages is the impact of trade liberalisation, through falling customs duties within FTAs, on ad valorem excise tax bases. Faced

with the issue of shrinking excise tax bases, policy makers are currently investigating ways to reform excise tax bases. Potential reforms include shifting the point where an ad valorem excise is calculated down the supply chain to the wholesale or retail level.

Policy makers should exercise caution when considering alternative excise tax base valuation methods. If the tax base calculation moves down the supply chain, then in practice, so too should the physical taxing point. However, such reform requires the existence of comprehensive mechanisms to manage the transfer of an excise liability. Many countries around the world utilise such systems, including 'bonded warehouses', however such infrastructure is limited across ASEAN. A more effective potential solution would be to change to a specific volumetric (per LPA) basis, which would provide revenue certainty and sustainability, regardless of customs duty liabilities.

Avoidance of double taxation on alcohol beverages

A key principle underpinning excise taxation is that an excise should only be applied once to a good – either upon production or importation. As ASEAN grows in to a more integrated regional economy, producers and suppliers will continue to utilise existing supply chains and innovate new ways to move goods into market.

Growing and diversifying trade will require taxation authorities to readily adapt to the needs of a regional approach to alcohol production activities, including manufacture, transportation, dilution and bottling. Effective and growing regional trade can only occur within an open and transparent taxation environment, without unforeseen circumstances such as inadvertent double taxation across multiple markets.

5.2.6 Issues impacting the ASEAN investment environment

As outlined earlier, regional integration through the AEC 2015 process is recognition by ASEAN member countries of the benefits of enhanced regional trade. Central to this process is a reduction of, or reform to, taxation and regulatory barriers that currently inhibit the free flow of goods and services throughout the region.

ASEAN member countries have already moved considerably to lessen formal barriers to trade through the ASEAN Free Trade Agreement (AFTA) and ASEAN Trade in Goods Agreement (ATIGA) process. AFTA and ATIGA have overseen the reduction or removal of customs duties on goods traded amongst ASEAN countries. This process has resulted in a lower 'landed cost' value for imported products, with customs duties no longer contributing to the value of goods after they have left the control of Customs authorities. Given that alcohol beverages have been (and in several cases continue to be) levied with comparatively high MFN customs duties in comparison to other products, falling customs duty rates has also led to a reduction of a considerable revenue stream to government. Furthermore, as outlined earlier this also leads to a reduction in ad valorem excise tax bases.

Given that customs duty reductions are designed to stimulate increased trade and economic activity across Southeast Asia, ASEAN policy makers should be wary of short-term (and short-sighted)

measures to repeal the reductions in previous trade barriers. *In particular, the imposition of additional duties to offset or countervail the impact of customs tariff reductions as part of the AFTA/ATIGA/AEC process is against the spirit of ASEAN regional integration. Such measures should be discouraged for alcohol beverages as they will only act as an inhibitor to the ultimate goal of free-flowing trade and investment across the region.*

5.3 Automobiles

The current excise tax regimes on motor vehicles in all 10 ASEAN countries are essentially an ad valorem system, mostly on the basis of engine capacity (Brunei, Myanmar and Singapore are the only countries using the same rate regardless of the engine sizes). Special reduction in rates also applies to specific types of vehicles (Laos and Thailand) or fuels (Philippines, Thailand and Vietnam).

5.3.1 Overview of Automobile Excise Taxation

The purpose of automobile excise tax in principle should be to correct for the externality created by the use of cars that includes environmental damage, accident, traffic jams and dependence on oil (Santos 2010), for instance. In practice, this is reflected in the classification (or in certain cases, eligibility for rate reduction) criteria used such as CO_2 emission level, engine capacity and types of fuel used. This is consistent with externality-correcting principle of taxation, i.e. cars that are more environmental friendly are taxed less than those that are less so. In practice, however, there are other considerations that are involved when designing the excise tax structure for automobiles. For example, policy makers sometimes give preferentially lower rate to the types of vehicles that are considered necessary for the development of the nation. These considerations translate into different tax rates that would be applicable to the cars. The tax liability, however, will be a product of such rate and the tax-base value of a vehicle.

Excise Tax Regime

Essentially, therefore, excise tax regime for cars is ad valorem tax system with a catalogue of variables that are used to classify cars into different group with varying excise tax rates. Table 19 below shows commonly used criteria and their effects on the tax rate.

Factor	Tax Rate (+)	Tax Rate (-)
CO_2 Emission	High emission	Low emission
Engine Capacity	High capacity	Low capacity
Fuel Types	High percentage of fossil fuel	High percentage of bio fuel/alternative
Vehicle Types	Personal use oriented	Commercial use oriented

Table 19: Commonly used criteria and their effects on the tax rate

The key challenge for policy makers is how to choose which factor(s) to be used to classify automobiles into different groups and segmentation while ensuring consistency with the basic principles of a good tax system, i.e. efficiency, administrative simplicity, and in particular fairness and transparency.

Excise Tax Rate

Given the above consideration and the variety of automobiles available, the structure of the excise tax (or equivalent) would inevitably be a multiple rate structure. The setting of the rates will have a great impact on the types (models) of cars to be introduced into the market. For example, if the rates favor environmental friendly cars, then carmakers would focus on making available the cars that are most friendly to the environment, everything else being equal. Government can use these criteria to tailor its automotive industries and consumer in the long-term.

5.3.2 Overview of ASEAN automobile markets

Automobile market characteristics

The Economic integration of ASEAN countries benefits automotive industry since it makes the industry more suitable as a regional manufacturing base and stimulate intra-regional demand. Various government policies also help promote automotive industries and deter importation of vehicle produced outside ASEAN. The three main auto-makers in this region taking advantage of this opportunity are Thailand, Malaysia and Indonesia. However, the dominant carmakers are foreign carmakers who set their foothold and supply chain in this region, especially Japanese carmakers.

In 2012, ASEAN produced approximately 4.2 million motor vehicles a growth of 42% compared to the production in 2011. Over half this number is contributed by Thailand, whose manufacturing output reached 2.4 million units milestone. Thai carmakers made 68% growth in production due to recovery from production halt caused by flooding and government stimulus policy, i.e. tax rebate programme for first-car buyer.

ASEAN members have different demand for different type of vehicle, shown in the table 20 below. Only Thailand and Philippines have higher demand for commercial vehicle than passenger cars. Nevertheless, Thailand has increasing market share of passenger vehicle according with the increase of income of its people during the past few years. The rest of ASEAN has higher demand for passenger cars more than commercial vehicles.

Country	Passenger Vehicle	Commercial Vehicle	2012	2011	Variance
Brunei	17,854	780	18,634	14,555	28%
Indonesia	780,767	335,445	1,116,212	894,164	25%
Malaysia	552,189	75,564	627,753	600,123	5%
Philippines	48,328	108,326	156,654	141,616	11%
Singapore	32,724	4,523	37,247	39,570	-6%
Thailand	694,234	742,101	1,436,335	794,081	81%
Vietnam	43,692	36,761	80,453	109,660	-27%
Total	**2,169,788**	**1,303,500**	**3,473,288**	**2,593,769**	**34%**

Table 20: Sales of Motor vehicle among 7 ASEAN countries during the year 2012
Source : AEAN Automotive Federation

Automotive industry is one of a key manufacturing network in ASEAN. The industry is growing at a fast pace. Carmaker deployed their manufacturing base in the country which has the most appropriate economic environment and ease of doing business where they can produce cars at the lowest cost and then export those cars to other ASEAN countries using opportunity of AEC.

5.3.3 Automobile tax systems across ASEAN

All ASEAN members use ad valorem excise tax structure, with exception of Brunei and Singapore, engine capacity and/or number of seats are used as classification criteria. Table 21 below shows the corresponding tax rates for all ASEAN members.

Country	<2000cc	2-3000cc	>3000cc	10-16 seat	>16 seat	Pick-up
Brunei	20%	20%	20%	20%	20%	20%
Cambodia	10%	45%	45%	20%	20%	
Indonesia	20%	40%	75%	10%		
Laos PDR	65%	75%	90%	25%	20%	20%
Malaysia	80%	90%	105%	105%	105%	
Myanmar	25%	25%	25%	25%	5%	
Philippines	15%	50%	100%			
Singapore	20%	20%	20%	20%	20%	20%
Thailand*	30%	40%	50%			3%
Viet Nam	45%	50%	60%	30%	15%	15%

Table 21: Automobile excise tax rates of motor vehicle in ASEAN

According to the table, the excise tax rates increase correspond to the increase of engine capacity, except for Brunei, Cambodia ,Myanmar and Singapore, although none of these countries have automotive manufacturing sector[42]. Other countries which have automotive manufacturing sector take advantage of excise tax rate by levying high rate leading by Malaysia Thailand and Indonesia. Despite the high tax rate, these countries have leading automotive sector compare to other ASEAN countries. Laos is the only one with no automotive manufacturing sector but has relatively high excise tax rate.

Some countries further classify automobiles based on specific characteristics that would allow qualified items to subject to different rates as summarized in the table 22 below.

42 Taken from "*Excise taxation of key commodities across South East Asia: a comparative analysis ahead of the ASEAN Economic Community in 2015", World Customs Journal,* Rob Preece

Country	Special Category
Indonesia	1. 4WD 1500-3000cc 40% 2. Sedan/station wagon <1500cc 30%, Sedan/station wagon >1500cc 75%
Laos PDR	1. for engine sizes below 1500cc 60% 2. for hardroof jeeps add 5% to rate 3. soft roof jeeps 30% 4. relates to 2 door pickup only, 4 door pickup pays 25% 5. trucks pay 10%
Malaysia	1. <1800cc 75%, 2500-3000cc 105% 2. Commercial vehicles 0% 3. MPV and vans assumed all >2500cc: <1500cc 60%, 1500-1800cc 65% 1800-2000cc 75%, 2000-2500cc 90%
Philippines	1. selling price ex-excise and VAT 2. diesel engines have cc concession 3. gasoline engines 1600-2000cc and diesel engines 1800-2300cc 35%
Thailand	1. 2000-2500cc pays 35% 2. where using alternate fuels (5% discount rate) 3. eco cars <1400cc 17% 4. electric cars 10% 5. other concesions PPV <3250cc 20% and Double cab <3250cc 12%
Viet Nam	1. cars which run on alternate fuels (ex bio-fuel) pay 70% of headline rate 2. cars which run on bio-fuel pay 50% of headline rate

Table 22: Country specific criteria

5.3.4 Relevant Examples For Automobile taxation in ASEAN

European Union

The aim of the European Commission is mainly to improve the functioning of the internal market by removing existing tax obstacles for transfer of passenger vehicle from one Member State to another and restructuring of tax bases in the European Union within the meaning of inclusion of carbon dioxide emissions caused by operation of vehicles. It is obvious that the aim, at least for now, is not a harmonization of tax rates, or the obligation to implement new taxes, David (2011)[43]. There is little EU legislation or requirement in the area of passenger car taxation. A key documentation for the EU would be a proposal for a Directive presented in 2005 that would require Member States to re-structure their passenger car taxation systems. The proposal contains three elements;

- Abolition of car registration taxes over a transitional period of five to ten years.

[43] In his paper David formulates a suitable model of road tax in theory, based on exploration and selection of theoretical requirements imposed on taxes for the Czech Republic.

- A system whereby a Member State would be required to refund a portion of registration tax, pending its abolition, where a passenger car that is registered in that Member State is subsequently exported or permanently transferred to another Member State.
- The introduction of a CO2 element into the tax base of both annual circulation taxes and registration taxes.

"Most Member States levying taxes based on the technical specifications of a car do so by differentiating according to technical performance (e.g. engine size or power) or the amount of CO2 emissions. Often, the thresholds have been set according to national market characteristics or national policy ambitions valid at the time of their introduction, and also having net revenue implications of successive reforms in mind.

Car manufacturers have - wherever economically meaningful - adjusted their supply to these design features of car taxes, notably by supplying cars to their main markets that remain just below certain thresholds, such as providing cars with engine sizes of 1599 cc or 1999 cc.

However, these thresholds differ from country to country. This absence of harmonisation, thus, triggers a 'technical' fragmentation of the Single Market. As a result, potential economies of scale of a Single Market with around annually 13 million new cars being registered cannot be exploited in full, having a negative impact both on the competitiveness of the industry and the effectiveness of incentive schemes. The cost of cars is also raised as a result. This is because a fragmented system induces car manufacturers to waste resources on fine-tuning cars to different thresholds, and reduces the cost-effectiveness of European climate policy."[44]

5.3.5 Automobile Excise Tax for the AEC

From the EU example and to promote the core features of the AEC, e.g. single market and production base, ASEAN members could establish a roadmap for harmonization on selected classification criteria, which in light of the international development and the trend of the industry, CO_2 emission would be a number one priority. The harmonization of the classification criteria and their threshold levels would strengthen the single market and production base philosophy, especially in respect to attracting new technology. Carmakers would be much more focused in developing and launching new technologies in the region if the benefits of doing so are no longer limited to only one or a few locations. Of course, members will still have the freedom to choose their own tax rates and to introduce additional classification factors tailored to the specific needs of each location.

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[44] Taken from the COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE: Strengthening the Single Market by removing cross-border tax obstacles for passenger cars

{**SWD(2012) 429 final**}

DISCUSSION QUESTION:
DO WE NEED A HARMONIZATION ROADMAP FOR THE CLASSIFICATION CRITERIA AND THRESHOLD LEVELS?

5.4 Non-alcohol beverages

Excise tax is only applied to non-alcohol beverages in four of the ASEAN countries – Cambodia, Laos PDR, Myanmar and Thailand. However, in terms of future regional excise reforms, some of the other six non-taxing countries are considering introducing an excise within the next one to two years, including Indonesia, Malaysia and Vietnam. In the context of this ASEAN excise study, and excise reforms ahead of the AEC, the taxation of non-alcohol beverages has become a key discussion area and a good opportunity to look at all of the relevant policy considerations.

This discussion paper will therefore be slightly different to those of alcohol, tobacco and motor vehicles, as it will look to address the initial policy question of "should an excise be introduced on non-alcohol beverages", before addressing issues around moving towards best practice excise taxation policy and administration.

The main objectives behind introducing an excise tax on non-alcohol beverages are likely to be either raising additional revenues and/or claims of health motivation.

Looking at the excise taxes of ASEAN, four countries namely Cambodia, Laos PDR, Myanmar and Thailand levy a tax generally on non-alcohol beverages. Looking at Table 23 below,[45] we see that all excise taxes are ad valorem based and as such linked to the price/quality of the product and the spending ability of the consumer, suggesting each excise is purely a revenue raising instrument. Further, rate differentials in these three countries see higher excise rates for soda water than other beverages, including sweetened sodas and juices, and therefore none are targeting sugar content on so called 'health grounds'.

Country	Soda Water	Carbonates	Other
Cambodia	10%	10%	10%
Laos PDR	5%	5%	10%
Myanmar	5%	5%	5%
Thailand	25%	20%	20%

Table 23: Current non-alcohol excise taxes in ASEAN

Should an excise be applied to non-alcohol beverages? A key principle in tax policy is that the objective of an indirect tax should be neutrality, or the principle that the tax rate, tax base and tax structure should not impact markedly on investment, production or consumption.

Tax policy can however, in certain limited circumstances include the need to levy 'special' taxes or discriminatory taxes such as an excise tax, in response to the externalities (or harm) associated with the consumption of certain goods and services. These products are usually alcohol, tobacco, fuels,

[45] Adapted from Phase I ASEAN Excise Working Tariff

motor vehicles and gambling.[46] The international Monetary Fund (IMF) in its 'handbook' tax law design and drafting, believes that an excise system should in fact be limited to just a 'few principle' groups, and to further remove 'vexatious' and 'regressive' excises in favour of general consumption taxation.[47]

Therefore, a key question arises as to whether a discriminatory tax on non-alcohol beverages is needed. What are the externalities behind the consumption of such beverages which need addressing through a discriminatory tax such as a non-alcohol beverage excise tax. If the policy intent is not in response to identified externalities, but is simply to raise revenue, then we need to return to our first key principle of neutrality in tax policy, where taxes such as VAT are likely to conform. This discussion paper will come back to the question of revenue raising and the effectiveness of using an excise tax on non-alcohol beverages for this purpose.

5.4.1 Externalities in the taxation of non-alcohol beverages

For the purposes of analysing this point, research was conducted over several "health-based" non-alcohol beverage excise taxes from Europe and the United States. When seeking to apply a discriminatory tax like excise, policy makers need to look carefully at what product, products or components are being targeted in the tax measure. From the study of the few countries within Europe who tax beverages, and in the United States, it appears that government policies aimed at reducing weight gain and its related health impacts are largely targeted at a single category of non-alcohol beverage - namely sugar sweetened carbonated soft drinks. This suggests that weight and obesity issues are primarily the result of consumption of sugar in sweetened beverages (although it was noted that the recently introduced soda tax in France was part of an austerity measure raising revenue, and the paper will return to this point).

This 'sugar content' issue requires significant analysis in the context of addressing health-related objectives, as literature now suggests that it is more than just sugar intake in a consumer's diet which leads to weight gain. Targeted excise taxes levied on a health or social basis to influence consumption are only effective where there are no readily available substitutes, and ineffective where say a tax on a sugar sweetened carbonated soft drink is substituted with another sweetened beverage like a juice, flavoured milk, RTD coffee or tea, etc.

Potentially more significant is a person's overall "energy balance" in which policy makers need to look at more than just energy intake from the consumption of foods, but also look at 'energy expenditure'. The Food & Agriculture Organisation (FAO) and World Health Organisation (WHO) have studied extensively the daily needs of the body from which 'energy requirements' have been established, and which are in fact different for different groups of people, for example a nursing mother, growing child, or a physical labourer will need more energy intake each day than say for an office worker or elderly person. [48]

[46] Cnossen (2005) *Theory and Practice of Excise Taxation* pp3-5
[47] International Monetary Fund (1998) Tax law design and drafting, Chapter 8, p6

[48] FAO (2007) Human Energy Requirements seehttp://www.fao.org/docrep/007/y5686e/y5686e04.htm

From these FAO and WHO studies, the main sources of energy intake are fats, carbohydrates followed by proteins, whilst the main areas of energy expenditure are dependent upon the person and whilst everyone expends energy in metabolism, other main areas are in growth, lactation, and pregnancy. The largest variable energy is physical activity, and indeed where there is a high energy intake but little physical activity, then there is the greatest chance of 'energy imbalance' and the associated health risks.

Thus critically, tax policy makers in this context should be taking care not to just address one single food group as energy intake, but rather look at policy in the context of overall energy imbalance. As such, even a broader excise on all non-alcohol beverages will not address all weight gain issues with energy coming from a variety of sources that are unlikely to be taxed. Obesity related issues can also be clearly linked to lifestyle changes and a drop in physical activity and a rise in sedentary activities – which cannot really be addressed through the excise system.

The World Health Organisation (WHO) has examined these issues and set out a "Global Strategy on Diet, Physical Activity and Health" in which fiscal measures such as taxation to influence the price of certain foods and through subsidies to direct consumers to more active recreational activities by supporting outdoor parks and sporting facilities are one element of a holistic strategy to address obesity-related concerns.

However, both the WHO in its strategy, and the OCED in its "2012 Obesity Update" are concerned that taxes which raise the price of products such as soft drinks sometimes result in unintended consequences, including consumers:[49]

- cutting back on nutritious foods to ensure they have sufficient spending power to keep purchasing the same quantities of taxed foods;

- using substitute food and beverages which are not taxed but contain an identical and sometimes higher amount of calories, for example substituting a sweetened fruit juice, an energy drink or a flavoured milk for a soda drink;

- absorbing the additional financial burden of the tax and maintain existing diets;

- changing their mix of food and beverage intakes to one which may actually contain a higher amount of calories; and / or

- gaining a mind-set from the tax that any cut back in sweetened carbonated soft drinks allows them to increase consumption of other foods which may have more calories, for example "not buying a soda means I can buy a cake" where the cake may be higher in calories.

Thus the OECD calls for a more comprehensive approach to dietary choices and policies which is more than just tax-based in nature. Where taxes are used, the OECD says they need to take account

[49] OECD (2012) *Obesity Update* http://www.oecd.org/health/49716427.pdf

of consumer behaviour in response to price changes and the range of possible food and beverage substitutes available.

5.4.2 Non-alcohol beverages as a revenue raiser

Introducing an excise tax on non-alcohol beverages might raise excise tax revenue but could result in substantially less revenue generation than anticipated and may even result in lower revenues overall. Confirmation of this and the extent of the increases would depend on factors such as own price elasticity and substitution effects, which in turn would likely depend on what products were subject to excise and at what rates. The price changes within each category of beverage and the responses by consumers to these price changes are the key to answering this question.

Here tax policy officials need to understand their local markets, and where possible undertake economic modeling of their markets in order to try and predict the likely consumption changes. Where the range of beverages to be taxed is less sensitive to price changes, then excise collections could increase. Where consumers are more sensitive to price changes then as taxes are introduced, sales will fall and/or move to lower-priced beverages, meaning a less effective excise revenue source. Alternatively, manufacturers will try and absorb as much of the tax as they can, meaning that profits will be cut and revenue simply shifts from income taxes to excise tax.

Looking at the revenue question more broadly is perhaps significant – as indeed a discriminatory tax like excise will generally have the effect of increasing prices and curbing some level of demand, and again this will have a broad impact that reverberates throughout the economy. As demand declines, the entire value chain (upstream suppliers, downstream distributors/retailers, and the employees of both) could see their tax payments (corporate, VAT, payroll, etc.) reduced. Therefore if revenue collection is the prime objective of a new excise tax on non-alcohol beverages, then tax policy officials will need to consider the impact not just on excise taxation receipts, but what will happen in respect of other tax revenue streams such as VAT, sales taxes, payroll, and income taxes, as the new excise tax impacts consumption and economic activity down the value add chain for the products.

To look at this question of the relationships between excise and other indirect and direct taxes, a case study has been included from Egypt where indeed the special sales tax on non-alcohol beverages was cut by more than half. As the Egypt example shows, policy makers do need to consider the impact on economic activity and other tax receipts should an excise be introduced or increased.

Case Study

Egypt cuts soft drink tax by 62% and tax revenues from soft drinks increase by 13%

In 2005 tax reform of Egypt in 2005 included a cut in the sales tax levied on bottled soft drinks from 65% of retail price to 25%, where it remains today.[50] It should be noted that the sales tax cut did form part of a broader reform package that applied the same cuts to some other targeted products as well as reducing income tax rates and that also generated some economic stimulus.

However, the soft drinks industry of Egypt was identified as a 'stand out' success from the reforms, particularly the effective 60% cut in the sales tax rate which helped spur an immediate "double digit growth in sales."[51] From this growth the overall tax paid by the soft drinks industry in Egypt grew by 13%, and combined with the associated economic activity surrounding the growth such as employment and profitability in value add industries, the actual "full tax impact" has been estimated at a 20% tax revenue increase.[52]

In terms of excise type taxes being levied on non-alcohol beverages, an excise tax is still in place in several countries, but primarily in developing countries within Africa, the Middle East, and Asia. Here such products are included in a range of goods seen as 'luxury goods' and the same excise systems extend into other commodities such as perfumes, jewellery, carpets, crystal glass ware, etc. with the aim of establishing a progressive tax on the spending of the wealthy. These types of excise taxes are distinguished by their ad valorem nature, rather than being targeted at some element of perceived harm through a specific tax rate approach, and as such are designed simply to raise revenue.[53]

It is important to note at this point that in terms of using excise taxes on 'luxury' or 'consumer' goods in developing countries, the motivation also comes from the ineffectiveness of tax administrations in these types of countries to ensure collections from income taxes, profit-based taxes, or broad-based consumption taxes. In developing economies with limited tax administration capacity, excise taxes are attractive in this context as they are applied to a limited range of goods (and services), provided by a limited range of manufacturers who can be more readily controlled via means such as excise officers being stationed in the manufacturers premises.

50 Deloittes (2012) International Tax : Egypt highlights 2012 http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/2012/dttl_tax_highlight_2012_Egypt.pdf access 27/11/2012

51 http://www.oxfordbusinessgroup.com/news/high-wire-industry-attracting-record-levels-investment-and-stripping-down-bureaucracy-w accessed 28/11/2012

52 Oxford Economics (2009) *The case for excise tax reform for non-alcoholic beverages in Thailand* Unpublished

53 This study identified the following excise rates: Turkey 20%; Zambia, Egypt, Chad, Zimbabwe 25%; Uganda, Ethiopia, Ghana 50%; Thailand 25% or 20% (effective rates), Laos, Cambodia 10% . Thailand has a rate which the greater of 25% or 0.77 baht per 440ml unit (soda water), or 20% or 0.37 per 440ml unit (general beverages).

With regard to soft drinks, as a percentage of excise collected, beverages in these categories are relatively small, with reported ranges of less than 0.1% in Tanzania,[54] 0.3% Turkey,[55] up to 3.6% of total excise collections in Thailand, although this figure could be a higher than normal with the significant reduction of diesel excise tax rate.[56]

Thus excise taxes on a product like non-alcohol beverages when used appear to be only a relatively small source of tax revenue in their own right, with the more likely effect of operating to reduce tax revenue from other sources of tax such as VAT and profit-based taxes and as such is often a somewhat questionable levy to retain or implement.

5.4.3 Price and income elasticity effects in the decision to apply an excise

The effectiveness of introducing an excise tax on non-alcohol beverage will be impacted upon by consumer responses to the prices, including whether the consumer sees each type of non-alcohol beverage as a 'luxury' or a necessity.

[54] Osoro N, Mpango P, and Himwinyvua H (2010) An Analysis of Excise Taxation in Tanzania African Economic Policy Analysis Discussion paper 72
[55] Presidency of Revenue Administration "Excise Duty System and Tobacco Taxation in Turkey 2011 www.gib.gov.tr presentation accessed 27/11/2012
[56] Excise Department of Thailand website "tax statistics income by commodity by fiscal year" http://www.excise.go.th/index.php?id=32&L=1 accessed 27/11/2012

INCOME AND OWN PRICE ELASTICITIES OF NON-ALCOHOL BEVERAGES BASED ON INTERNATIONAL STUDIES

Studies	Product	Income elasticity	Compensated own price elasticity
Dharmasena and Capps (2009)	Regular soft drinks	1.506	-1.903
	Diet soft drinks	1.276	-0.957
	Bottled water	0.364	-0.070
	Fruit drinks	1.259	-0.082
	Fruit juices	0.649	-0.822
	Isotonics (energy drinks)	2.604	-5.937
	Coffee	0.628	-0.464
	Tea	0.752	-0.509
	High-fat milk	0.798	-0.733
	Low-fat milk	1.059	-0.761
Zheng and Kaiser (2008a)	Soft drinks	0.997	-0.151
	Milk	0.614	-0.154
	Juice	0.656	-0.172
	Bottled water	0.029	-0.498
	Coffee/tea	3.144	-0.083
Zheng and Kaiser (2008b)	Soft drinks	0.381	-0.164
	Milk	0.243	-0.102
	Juice	2.891	-0.458
	Bottled water	0.062	0.044
	Coffee/tea	3.049	-0.260
Kinnucan, Miao, Xiao and Kaiser (2001)	Soft drinks	1.238	-0.137
	Milk	0.406	-0.169
	Juice	0.698	-0.361
	Coffee/tea	1.876	-0.249
Yen, Lin, Smallwood and Andrews (2004)	Soft drinks	1.010	-0.520
	Milk	0.800	-0.590
	Juice	0.900	-0.350
	Coffee/tea	1.130	-0.470

Table 24: Recent international studies: income and price elasticities by non-alcohol beverage category

The study found quite divergent results as to the own price elasticities relating to soft drink consumption, and as such a divergent range of opinions as to the effectiveness of 'price based' policies to reduce calorie intake via the excise tax system. Table 24 above provides a summary of recent elasticity studies over the non-alcohol beverage market and highlights how difficult it has been to gauge consumer's sensitivity to price changes to soft drinks, and how soft drinks are perceived by consumers in terms of an everyday or discretionary purchase.[57] In terms of the United States where price elasticities have regularly been studied, the own price elasticity for non-alcoholic beverages appears to sit in a wide range of -0.13 to -3.18, with an average factor of -0.79.[58]

[57] Dharmasena and Capps, 2009, Zhen and Kaiser, 2008a, Zheng and Kaiser, 2008b, Kinnucan et al 2001 and Yet et al, 2004. As cited in "Modelling the impacts of Thailand's soft drinks market to excise reforms" Allens Consulting Group, 2011 Unpublished
[58] International Tax & Investment Centre (2013) *The Impacts of Selective Food and Non-alcoholic Beverage Taxes* p8

Therefore, when looking at the impact of an excise tax on soft drinks, Table 24 suggests that the price sensitivity of consumers is very different in different markets and within the full range of 'soft drink' with the non-alcohol beverage market – different beverage types have different price sensitivities. Looking at carbonated soft drinks like sodas, which are often singled out for discriminatory taxation - for a 10% increase in price the estimated or projected reduction in consumption ranges from between 1.5% and 19%. From this, it is critical for tax policy to properly understand the products available, the pricing of product and the consumer's response to price changes in the market before considering any form of excise type tax.

It is also interesting to note the same studies in Table 24 also include findings in relation to income elasticities. The same studies in Table 24 all indicate positive results meaning that where additional spending power becomes available, the consumer will purchase more of the beverages. Water and milk have low positive results across the studies reflecting the view that these products are 'necessities' of life, whereas sugar sweetened beverages such as sodas, juice drinks, and energy drinks are viewed more as discretionary and helps confirm why these same products are more price sensitive as they are not viewed as 'essential'.

Finally, there is the question of substitution effects after the relevant price changes. These relationships also need to be understood. The study could not find much work published on the cross price elasticity effects but what has been published suggests that the closest substitutes for carbonated soft drinks are "juice products" and "whole cream milk".[59] From just this one study some interesting tax policy questions begin to emerge. Firstly, what if the calories contained in those juice substitutes is the same or higher than for the carbonated soft drink that has not been consumed? Secondly, what if the calorie content of the milk (or calorie content of the flavoured milk), is greater than the carbonated soft drink that has not been consumed? What about the fact that the whole cream milk contains fat that is not contained in most carbonated soft drinks? Finally, what if the substitute for the soft drink is beer, such as has been suggested in a recent 'field study' in Utica, New York.[60]

The risk at this point to consider is that on health grounds, a discriminatory excise on a single or narrow range of non-alcohol beverages may cause a higher overall calorie intake when the objective was to in fact tackle weight gain and obesity related harm.

Several studies on the effectiveness of existing soft drinks taxes in the United States questioned their effectiveness in regard to reduction in incidents of weight loss and obesity levels. One study examining those US States with a soft drinks tax, that the taxes "have little influence on Body Mass Index (BMI), overweight or obesity in children and adolescents" for whom it is most important that

[59] See Pofahl G, Capps O, Clauson A (2005) Demand for non-alcoholic beverages: Evidence from the ACNielsen Home Scan Panel and Schroeter, Lusk and Tyner (2008) in Jeffords J (2010) the use of Soda Taxes for Obesity Prevention
[60] Wansink, B et al (2012) "From Coke to Coors: A field study of a sugar sweetened beverage tax and its unintended consequences" as cited in the New England Journal of Medicine 367:15 October 2012

the policy impacts.[61] This study adds that the prime factor for this lack of positive impact is likely the move to other and often higher caloric beverages as a response to the price increases caused by the tax.

Another study of the same US States suggests that when considering BMI as a measure of effectiveness of such taxes, there was a very minor, indeed insignificant impact, with a 1% increase in the tax rate resulting in a 0.003 percentage points drop in BMI, leading to the conclusion that there is "little dynamic effect of soft drink taxes on weight.[62] The ineffectiveness of soft drinks excise type taxes to reduce weight and BMI (as representative measures of effectiveness) seems to be related to the effect of substitution and the availability of other food and beverages to replace, and some cases actually increase, any calories not consumed via taxed soft drinks.

In Europe there have been some interesting developments to also note. Denmark recently introduced a tax on foods with more than 2.3% saturated fats ("Fat Tax"), with a proposal to extend an existing tax on confectionary to all foods which exceeded a certain sugar content ("Sugar Tax"). On 10 November 2012, the Treasury announced both the cessation of the "Fat Tax" and the abandonment of the proposed "Sugar Tax", with the main reasons cited as being:[63]

- heavy criticism for the impact on consumer prices, particularly on lower income families and as such provides for a "better social profile";
- corporate administrative costs;
- loss of 2,400 Danish jobs in the food and associated industries; and
- consumers moving to purchase targeted foods across neighbouring borders contributing to revenue losses to the budget and to Danish food manufacturing.

Another interesting development was the introduction by the French Government of a "soda tax" from 1 January 2012 on caloric and non-caloric carbonated beverages set at an equivalent of 2 Euro cents per can.[64] However, there was some confusion as to the objective of this soft drink tax, as despite a "health angle" in the announcement, this new soda tax was seemingly introduced as part of a greater austerity program to help the finances of the country**,** and would appear to be more of a small revenue raising tax than providing a clear health outcome. Here tax policy makers are sending confusing messages which is not helpful in policy analysis – why is a health measure being announced by the Ministry of Finance as part of a revenue raising measure, and why isn't the Ministry of Health devising and proposing the tax? In effect, it is likely that the design, structure and rates of a heath based tax will be different to that of a revenue raising tax.

[61] Fletcher J, Frisvold D and Tefft N (2010) *The effects of soft drink taxes on child and adolescent consumption and weight outcomes* Journal of Public Economics 94 (2010) p973

[62] Fletcher et al (2008) http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2908024/ accessed 21/11/12
[63] "Lower taxes for consumers and business" Treasury Ministry of Finland see http://www.skm.dk/public/dokumenter/presse/Faktaark_afgiftsogkonkurrencepakke.pdf accessed 03/12/2012
[64] "France to press ahead with soda tax" 6 October 2011 http://www.thelocal.fr/page/view/1401

5.4.4 Tax policy development tools

As is seen from the analysis to date, there is a significant amount of research required into the question of whether to introduce a new non-alcohol beverage excise tax. Significantly, that research needs to ensure that the intended policy outcomes will be met by the introduction of the new tax. In this regard, two steps are discussed: understanding the market and economic modeling, and importantly how these concepts can be applied in countries where excise is also levied but perhaps reform is being contemplated.

It is important for tax policy officials to collect data and properly understand the following:

- the categories of product which comprise the non-alcohol beverage market;
- the sales volumes of each of these categories;
- the retail price and cost structure of these representative products; and
- where possible, historical data of the sales volumes in each product category.

The basis of this data is to understand both the impact on pricing with any new tax (or any reform to existing excise taxes where applicable), and to understand the relationships between the products and product categories where these change pricing relative to each other. From this knowledge, key economic factors like price elasticity and substitution effects can be derived which assist in understanding these market changes, and therefore whether key policy objectives are to be met.

A useful tool here is economic modeling, in which all these various input factors are linked to provide market outputs. A common template for such modeling is found in Figure 15 below and operates through various inter-connected sub-components as follows:

- New tax policies are proposed in terms of structures, tax bases and excise tax rates (or amendments to existing structures, tax bases and rates), for each representative product, the new tax scenario calculates the excise tax payable;

- As an indirect tax, the excise payable then changes the price of a product by having the burden added to the current cost structure (or changed in an existing cost structure), with excise payable being captured in a 'pricing model' in which all retail prices of all representative products are changed in line with the new excise reform scenario;

- With the new retail prices, and using the price elasticity, substitution and other factor effects, new sales volumes for each product category are calculated in a 'sales model';

- The new sales volumes for each product category are then linked to the proposed excise reform scenarios to calculate what new revenue (or what changes to existing revenue) will result from the excise tax reform scenarios.

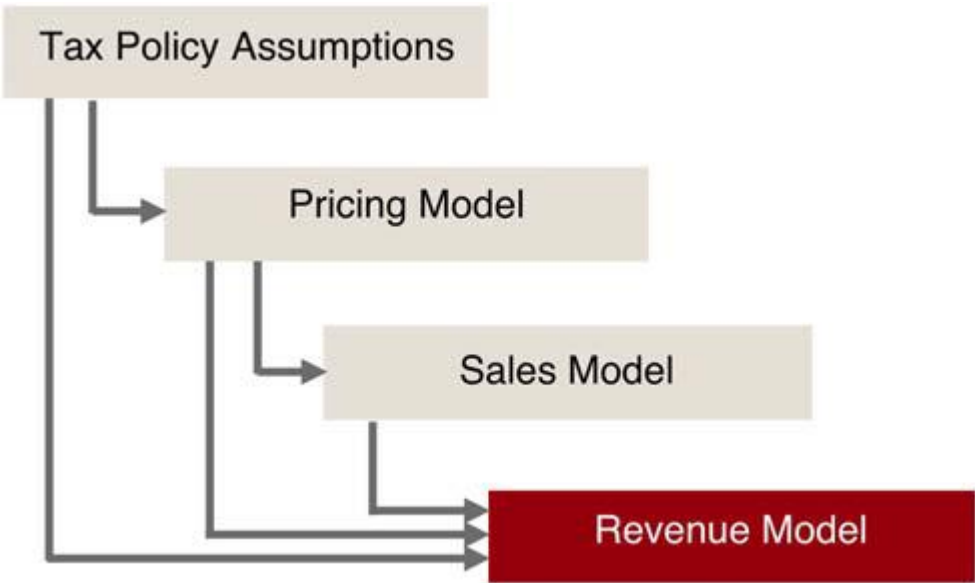

Figure 15: Template of standard economic model for an excise reform scenario

The output is used for analysis that policy objectives will be met, and can assist with adjustment of tax design to better insure policy objectives will be met if initial reforms do not. From this type of standard economic model, output would include:

- Changes to the retail price of representative products in the market;
- Changes to consumption by product category and overall market;
- Total indirect tax revenue generated (or lost) by product category and overall by the new reforms (where indirect taxes are those which are included in the cost structure of a product such as excise, VAT and if applicable – customs import duties).

In terms of actual tax design, ie structure, tax bases and actual rates – these should be proposed using best practice as is discussed further below.

Finally, it should be noted that the model represented at Figure 15 is confined to just sales of products from manufacturers. It is worthwhile further considering the impact more broadly and where capability exists, seeking to model these wider impacts, particularly in relation to the 'value add' or entire supply chain for non-alcoholic beverages. The IMF believes:

> "Specific taxes, for example, on…nonalcoholic drinks, and carbonated drinks, should be relegated to the realm of curiosities. If any consideration is given to taxing other products, as mentioned in the sections above, or services, it is recommended that the advantages (revenue) be weighed against the disadvantages, such as discrimination, substitution, and administrative costs."

[65]

[65] International Monetary Fund (1998) Tax law design and drafting, Chapter 8, p16

5.4.5 Best practice non-alcohol beverage excise taxation

Where a government has decided to apply excise, then there are several key principles that need to be considered to ensure a 'best practice' approach is adopted:

Non-discrimination

Any new non-alcoholic beverage excise tax needs to be applied as broadly as possible, rather than trying to isolate one or two products. To levy excise on just one or just a few categories of non-alcoholic beverages, complexity rises considerably as producer tax payers properly assess and revenue agencies confirm the correct classification and tax rates of each product.

Discriminatory taxation within an industry will cause considerable tax administration issues as manufacturers will try and reformulate or adjust products to gain a more favourable tax classification or tax exemption. Definitions such as based on sugar content or carbonation for example, would be such products that seek to slightly adjust formulations.

The use of exemptions could be equally problematic, as when exemptions apply, again there is likely to be attempts to change formulations slightly to access the exemption. For example an exemption for say natural unsweetened fruit juice may see some look to add such juice to existing products to reduce excise or achieve the exemption.

As discussed above, discriminatory taxation within an industry also causes 'product substitution' issues where consumers switch their consumption to non-taxed products that are readily substitutable, with an associated revenue loss – the issue of substitution will be revisited below in the context of the review of excise and health objectives.

Tax base ideally a specific rate

The other area of tax design to highlight is that of the tax base and whether the excise should be applied on an ad valorem (value base) or as a specific rate per measure of volume. Where excise is levied as a specific rate, administration and compliance is far simpler as the excise is determined by a simple count of volume passing the taxing point, for example past a flow meter, or bottles within a carton.

Currently specific rate excise taxation is used in the Netherlands, Finland, Croatia, and is the also the tax base for the "soda tax" levied in the US State of Washington. Each uses a 'per litre' basis. The other major excise tax to note here is the soda tax of France which is on a 'per can' basis with a can being a 33 centilitre unit (similar to Thailand which uses a 440 millititre 'can' for the specific rate calculation).

If the government policy position is related to externalizing the harm from non-alcohol beverages, then specific rate excises best reflect this as the tax relates directly to consumption, and not to value or quality of the product consumed.

Ad valorem taxes are far more complex to administer, and often disputes arise between taxpayers and revenue agencies as to what cost component should and should not be included in an excisable value. Further, in an ad valorem tax base, tax payers look to strategies to reduce excise tax liabilities by transferring certain costs past the taxing point, or using bulk or cash discounts, and other pricing strategies all designed to reduce the actual excisable values.

The IMF in its tax law design and drafting handbook also recommends specific rates of taxation for excise when the tax agency of the country imposing the excise lacks capability in tax administration.[66] Where that capability lacks, then the types of risks to the revenue as described above are more easily managed in a simple volume based assessment than a complex set of procedures to establish a particular value.

Currently, ad valorem based excises on non-alcohol beverages are applied in Turkey, Zambia, Chad, Zimbabwe, Ethiopia, Ghana, as well as the four ASEAN countries named in this study. It appears that developed nations are favouring specific rate taxation over the developing world that is using ad valorem.

Thus where excises are to be imposed, or are to remain in place on non-alcohol beverages it would appear that to reduce costs of administration and compliance for both revenue agencies and industry, excise needs to apply broadly to all beverages that can act as substitutes, and be levied on a specific rate basis.

Tax rate setting

That tax policy advisors are working with clear objectives in terms of the implementation of any new excise on non-alcoholic beverage. These objectives need to balance on-going investment levels, impact on value add businesses to the industry, revenue collection, and consumer impacts. This can be done by understanding both the market and the price sensitivities of consumers, and by subjecting any proposed excise tax reforms to some form of economic modelling or similar analysis to understand the effects.

DISCUSSION QUESTION:

IS YOUR COUNTRY CONSIDERING AN EXCISE TAX FOR NON-ALCOHOL BEVERAGES – IF SO WHAT ARE THE POLICY OJECTIVES?

OR

IF YOUR COUNTRY HAS AN EXCISE ON NON-ALCOHOL BEVERAGES TODAY – WHAT IS THE POLICY BASIS FOR THE TAX?

[66] International Monetary Fund (1998) Tax law design and drafting, Chapter 8, pp4-5

AND

DO YOUR TAX POLICY AREAS MEASURE MARKET IMPACTS ON NEW EXCISE REFORM PROPOSALS – IF SO, WHAT SORT OF TOOLS ARE USED?

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