

## THE CONSUMER OR THE TRADER – WHO DECIDES ON HOW A PRODUCT IS USED? *An analysis of the application of excise duty exemptions under Directive 92/83/EEC to alcohol*

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**Keywords:** EU law; excise taxes; not for human consumption; surrogate alcohol; CEE; economic analysis of law.

**Abstract.** Twenty-two years after adopting Directive 92/83/EEC, the European Commission initiated a review of the Directive because it did not correspond with the developments and the challenges, they pose for the alcohol sector. After six years of deliberation, amendments to Article 27.1. of the Directive entered into force this year, which, according to the study, will not address the critical problems with the Directive's application. The research analyses the concept of 'not for human use or consumption', the interpretation of which had been identified by experts and the EC as problematic and detrimental not only to the interests of Member States but also to their residents and legal entities. In particular, the study found that official sources and national systems use definitions that are linguistically and substantively different, which does not ensure homogeneity in the application of the Directive, which is one of the EC's priority objectives (harmonisation of the excise duty regime).

The second part of the study asks whether the Court of Justice of the European Union (CJEU) can resolve the problems of the article's interpretation. The case law on classifying products for taxation purposes is inconsistent and fragmented, selectively applied, and the judgments are often diagonally opposed. In one case, the CJEU relied on the consumer behaviour argument. In contrast, in another case, the Court held that the trader alone decides on the use of the product and that consumer behaviour is entirely irrelevant. This case is unique because the court legalised fraudulent schemes in selling surrogate alcohol, which is contrary to the EU's goals to prevent health risks.

Given that neither the CJEU nor legislative review and amendment can effectively ensure that the issue of excise duty is harmonised, the study invites us to explore the possibilities of changing the methodology on how court decisions are made. In particular, whether the issue of excise duty exemptions could be addressed by applying economic science. The study explores the concept of 'not for human use or consumption' by using the methodologies of mainstream post-Keynesian economic theory and mainline Austrian economic theory. The study finds that an analysis of consumer behaviour would ensure an effective interpretation of Article 27.1. of the Directive.

### INTRODUCTION

Under Article 27.1 (a) and (b) of Directive 92/83/EEC (the Council, 1992; the Directive) denatured alcohol is exempted from the application of excise duties. The Directive lays down that "alcohol

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which has been completely denatured in accordance with the requirements of any Member State” which have been notified under the procedure in Article 27.3 and 27.4 shall be exempted from the application of excise duties (Council 2014). Article 27.1 (b) stipulates that alcohol that is “denatured in accordance with the requirements of any Member State and used for the manufacture of any product not for human consumption” shall equally be exempted. However, Article 27.1 of the Directive allows the Member States to refuse granting an exemption its aim is to combat evasion, avoidance or abuse which may arise in the field of exemptions (Council, 2014). These provisions allow for Member States to protect their financial interests by ensuring that all excise duties can be collected (European Commission, 2014a). The first and so far last revision of the Directive was launched in 2014 (European Commission, 2014a), 22 years after the socioeconomic global changes, but also after significant changes in the composition of the EU. The European Commission (EC) initiated the review because the Directive was not keeping pace with the challenges and opportunities presented by new technologies and developments in the alcohol industry (European Commission, 2014). Researchers have identified a number of problems and inefficiencies that remain, which could distort the internal market European Commission, 2014b).

After 6 years of deliberation at the EU and Member State level, Council Directive (EU) 2020/1151 (Council, 2020) has been adopted, adjusting certain provisions of the original Directive. Following an independent study of the Directive and an ex-post regulatory analysis of the legislation, the European Commission has decided to make proposals to, inter alia, clarify and thereby simplify the application of excise duty exemptions, in particular, the exemption under Article 27(1)(b) of the Directive (European Commission, 2014b).

The scientific problem is that the amendments (Council, 2020) do not bring more clarity, on the contrary, they give more instructions on how to override the tax system, to the detriment not only of the state itself but also of its citizens. The aim of the research is to provide a methodology for product classification for tax purposes so that it ensures due application of the Directive and would be in line with the key aims of the EU regulations. The article aims to prove that, firstly, changing the laws will not benefit the EC’s goal to harmonize excise taxes. Secondly, it aims to defend the claim that the European Court of Justice (the ECJ; the CJEU) cannot provide case law arguments to clarify the exemptions under the Directive. Lastly, the article argues that the methodology of the Austrian economic law theory can ensure a uniform and just interpretation of the Directive and would aid in achieving the core goals of the European Union regarding public health and fair competition.

#### 1. DO THE AMENDMENTS ACTUALLY MEND THE APPLICATION OF EXEMPTION UNDER THE DIRECTIVE?

The Tax group experts who carried out the study of the Directive raised questions about the exemption under which Member States shall exempt products <...> when they are used in the manufacture of any product not intended for human consumption (Article 27(1)(b) of the Directive; European Commission, 2014b).

The updated text of Article 27(1)(b) (Council, 2020) states that such products shall be exempt from excise duty “where they are used in the manufacture of a product not intended for human consumption <...>; this exemption shall apply where such denatured alcohol is incorporated into the composition of a product not intended for human consumption“. Thus, ambitiously determined to adapt the Directive to changes and simplify its application, the EC has not found the correct instruments to explain in more detail that there is such a product “not for human consumption”.

## 2. LOST IN TRANSLATION

The above-mentioned expressions are the expressions used in the official translation of the Directive. The Lithuanian translations of the Directive give a lot of weight to the purpose element (i.e. which purpose the supplier specifies for the product). The wording used in the French version of the Directive [“denatured in accordance with the requirements of the Member State and used for the manufacture of products not intended for human consumption”] also makes the element of the intended use given by the supplier the most important.

The Lithuanian provisions of the Excise tax law (the Parliament, 2022), which transpose the Directive, brings a different perspective. The wording of the Excise tax law: “used for the manufacture of non-food products” (the Parliament, 2022). This significantly narrows the scope of the Directive’s exemption by introducing the two components “non-food product” and the use of the product intended by the supplier. It is important to note that the other exemption in the Directive (27.1(f)) already refers to foodstuffs and non-food uses, so such a translation may not cover all possible nuances.

The broadest definition is given in the original text of the Directive (which takes precedence in interpreting EU law). The English text of the Directive states that a product is exempt from excise duty if it is “not for human consumption”. This wording of the provision raises even more questions, as there are many possible interpretations, and leaving it as it is does not achieve the EC’s objectives of harmonizing both excise duties and exemptions from them. We can ask whether products “not for human consumption” are not intended, unsuitable or not used (i.e. typically not ingested). A seemingly minor linguistic difference can fundamentally change the interpretation and application of the whole excise duty exemption and the responsibility of the State and the supplier.

So we have at least three different linguistic interpretations of the Directive. Given the changes to the text initiated by the EC, it can be concluded that it is not efficient to address the problems related to the interpretation of the exemptions by amending the legislation, since even after long negotiations and deliberations, the EC has not come up with any proposals to improve the regulation of the application of the exemptions to “non-human consumption” products.

## 3. BUT ARE THE LEGAL ARGUMENTS AND NOT THE LINGUISTIC ONES?

Bene Factum (Judgment of the Court (Third Chamber), 2019) was the first and so far the only case before the Court of Justice of the ECJ to address the issue of taxation of surrogate alcohol. Al-

though such products are legal per se, the World Health Organization identifies alcohol surrogates as a type of “unrecorded” alcohol that poses both a financial risk to the State and health problems for people, implicitly identifying the implication that surrogates compete with alcoholic beverages (World Health Organization, 2021).

In the *Bene Factum* case, the Lithuanian State Tax Inspectorate and the Government indicated that, due to objective facts (which were not disputed even by the defendant itself), the mouthwash distributed by the company competes not with oral hygiene products but with alcoholic beverages (the Judgment of the Court (Third Chamber), 2019). Lithuania and the Czech Republic argued in the case that, in terms of consumers’ attitudes towards the product, the mouthwash in question competes with alcoholic beverages and should therefore be subject to the alcoholic beverages tax regime (the Judgment of the Court (Third Chamber), 2019).

After a formalistic assessment of the material in the case, ECJ held that, irrespective of how people consume a particular product, the taxability of the product is determined by the use to which the supplier puts the product (the Judgment of the Court (Third Chamber), 2019). Thus, the *Bene Factum* case did not take into account the behavior of consumers in relation to the product.

The opposite was the case in *Répertoire Culinaire Ltd* (Judgment of the Court (Third Chamber), 2010) where the ECJ relied on the “undrinkability” of the product to characterize the product in question in relation to the exception in Article 27(1)(f) of the Directive. The case concerned wine-containing products with spices and addressed the question of whether they should be exempt from excise duty. The ECJ’s reasoning was based on the behavior of the final consumer towards the product. In this case, the ECJ found that people will not drink these products in question because of the addition of salt and pepper to the wine (Judgment of the Court (Third Chamber), 2010). In this sense, the CJEU based its reasoning on the behavior of consumers towards the product, as it relied on the fact that such a product may not be considered drinkable by the final consumer. The intended use of the product as attributed by the product supplier was irrelevant in the case.

Moreover, in *Répertoire Culinaire Ltd* (Judgment of the Court (Third Chamber), 2010), the CJEU noted that “there have been no cases of abuse involving liquids such as those at issue in this case. It can therefore be presumed, almost without doubt, that the liquids confiscated will in fact be used for the manufacture of foodstuffs within the meaning of Article 27(1)(f) of Directive 92/83.”

The substance of the case is analogous to the situation in *Bene Factum*, the difference being that alcoholic beverages were considered to be foodstuffs in the former, whereas in *Bene Factum* there was a dispute as to whether the products in question were cosmetics or beverages. If the arguments and points of assessment of *Répertoire Culinaire Ltd* had been applied in *Bene Factum*, the opposite decision might have been reached.

Given that the CJEU has dealt with only two of the cases discussed above, it can be assumed that there are not enough legal arguments to deal with product classification disputes at the CJEU level. In addition, it is worth noting that a linguistic and systematic analysis of the provisions of the Directive does not provide any concrete answer.

#### 4. CAN MOUTHWASH COMPETE WITH ALCOHOLIC BEVERAGES?

According to the classical Keynesian economic theory, product competition and substitutability are solved by the evaluation of marginal and opportunity costs (Fernandez-Huerta, 2008). The EC has observed, in the context of addressing competition issues, that when assessing a particular market or product (in the context of entry restrictions), it is necessary to look firstly at the geographic market, where conditions are as homogeneous as possible, and also at the product market, looking at the specific markets where the supplier of the product meets demand and offers supply (Commission, 1997). Research on alcohol surrogates (cologne, mouthwash, antifreeze, etc.) has shown that price elasticities exist between surrogates and alcoholic beverages (Lang & Ringamets, 2016). This means that the demand for surrogates increases as alcohol prices rise. Studies also show that the consumption of surrogates is a particular problem in Central European countries (International Center for Alcoholic Policies, 2005). Thus, alcohol surrogates compete with alcoholic beverages both in terms of product and geographic market requirements, but this was not addressed in the first *Bene Factum* case on alcohol surrogates.

Mainstream post-Keynesian economic theory (i.e. the kind taught in universities and mostly followed by bank economists) follows the paradigm that man is rational, it is heavily focused on mathematics, is filled with all kinds of models, and is mostly about aggregate supply and demand (Fernandez-Huerta, 2008). This theory holds that when making decisions, for example when there is a change in supply (in terms of price or other components), people look at aggregate data, their long-term goals, financial resources, etc., but this raises questions in the specific case of surrogates and their consumers.

The mainline branch of economic theory, which includes Austrian economic theory, sees the existence of a single market defined by consumers rather than by economic or geographical elements, and also sees all products as in constant competition between one another, whereas the mainstream neoclassical post-Keynesian economic approach disregards including social phenomenon in their economic analyses (Pressman, 2003). This leads to the recognition that it is only individuals who make decisions and choices, although these are undoubtedly determined by the social environment (but not by what the distributor or manufacturer says on the product). Social phenomena therefore only become comprehensible if they are linked to individual decisions. This is a methodological individualist approach, which argues that people, with their unique goals and plans, are the origin of all economic analysis. Thus, decisions must not be made on the basis of geography or the product market, but on the basis of people's attitudes towards products, because, according to Austrian economists, people choose between many products and services, such as leisure time at the cinema, walking, spending time in museums or drinking alcohol.

Methodological individualism and purposive (but not necessarily rational) behavior have important implications for the way we carry out economic analysis of legislation. In order to explain various complex phenomena, such as exchanges, price formation, and to do so, it is necessary to recognize

that these phenomena consist of the actions of many individual actors. Only by assessing the goals and plans of individuals can we hope to make sense of the phenomena of the world. The theorems of mainstream post-Keynesian economics, i.e. the concepts of marginal utility and opportunity cost, and the principle of supply and demand, are derived from reflecting on the purposefulness of people's actions and attempting to aggregate behavior because it is less costly to do so and more convenient to apply when enacting new regulations.

When looking at the situation of consumption and regulation of alcohol surrogates, it is clear that it goes beyond the product market or the geographic (CEE) market to include the behavior of the consumer himself. Although mainstream post-Keynesian economic theory also assumes a rational consumer, the consumption of surrogates can be more appropriately described by the theory of the Austrian school of economics. The latter sees people and their behaviour as they are. In the case of surrogates, a person looks for the solution or product that is "next in line" to satisfy his needs (specifically, intoxication), without first assessing his socio-economic or long-term financial capabilities. For example, if mouthwash were taxed, a surrogate consumer would buy antifreeze; if this was taxed, cologne, etc.

#### 5. DOES THE BEHAVIOR OF THE DISTRIBUTOR OR THE MANUFACTURER MATTER?

The Directive specifies that exemptions under 27.1(b) of the Directive may be refused if the State suspects abuse and/or fraud (Council, 1992).

In the only case concerning surrogates, the Lithuanian State Tax Office argued that the trader had deliberately taken into account the fact that some people ingest mouthwash in order to become intoxicated (Judgment of the Court (Third Chamber), 2019). This conclusion was based on packaging labelling features such as taste, the indication of "degrees" on the front label, etc., which are not related to hygiene measures but directly imply competition with alcoholic beverages. In the case of *Bene Factum*, the trader was aware that its products were used as alcohol surrogates and that it did not compete with oral hygiene products, as well as the undisputed fact that the supplier deliberately shaped the appearance of its products in order to reflect the demand for surrogate drinks. However, the CJEU's decision in the *Bene Factum* case legalized a tax evasion scheme in the surrogate trade.

#### CONCLUSIONS

1. While the amendments to the Directive are intended to better reflect technological change, it is questionable whether the proposed changes will be able to cope with people's infinite inventiveness. The current legislative wording does not clarify what constitutes products not intended for human consumption. The key is to identify who determines the use of the product, especially in cases where the product is used for purposes other than those specified.

2. In the case of *Bene Factum*, the investigation should have been facilitated by the fact that the trader had an expressed intention and desire to have its mouthwash compete with alcoholic beverages, but despite this and previous case law, the decision was taken to rely only on the trader's formal designation of the product.
3. The phenomenon of surrogate consumption is best explained by Austrian economic theory, according to which people are not rational and look for substitutes to satisfy their own interests at the lowest cost - i.e., rather than considering aggregate data in the long term, they look for cheaper substitutes for what is "next in line" on their list of choices here and now. The starting point of the analysis is the individual and his unpredictable and irrational behavior, which determines how products are actually used. Application of this methodology would not only benefit the state's fiscal system, but it would also ensure a greater respect to public health and respect to fair competition – all of which are among the top priorities of the European Union and its Member States.

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