

# The Relevance of Consumer Behavior and Competition of Products to Levying Excise Duties on Cosmetics under EU Law

**Karolina Mickutė**

Vilnius University, Faculty of Law  
Research Assistant and PhD Candidate at the Public Law Department  
Saulėtekio ave. 9, LT-10222 Vilnius, Lithuania  
Tel. (+370 5) 236 61 75  
Email: <karolina.mickute@ff.vu.lt>

In *Bene Factum*, the Court of Justice of the European Union ruled that cosmetic products should be exempt from excise duty on alcoholic beverages if they contain ethyl alcohol regardless the actual use of the product (consumer behavior). In order to assess the prerequisites for the proper application of EU law in the field of excise duty, the article assesses the mechanism of determining product competition at the EU and International Trade Law levels, which is important for the classification of products for tax purposes, including the extent to which cosmetic products compete with alcoholic beverages, how private business is limited by consumer habits, and possible governmental intervention in this context.

**Keywords:** EU law, Excise duty, Exemptions, Definition of “products not for human consumption,” consumer behavior, cosmetics.

## Vartotojų elgesio ir produktų konkurencijos reikšmė produktų apmokestinimo akcizo mokesčiu atvejais

*Bene Factum* byloje priimtame prejudiciniame sprendime Europos Sąjungos Teisingumo Teismas nurodė, kad, neatsižvelgiant į tai, kaip kosmetikos priemonė yra naudojama, toks produktas yra atleidžiamas nuo akcizo mokesčio. Siekiant įvertinti tinkamo ES teisės reguliavimo taikymo akcizo srityje prielaidas, straipsnyje ES ir tarptautinės prekybos teisės lygmeniu vertinamas produktų konkuravimo nustatymo mechanizmas, kuris reikšmingas klasifikuojant produktus mokesčių tikslais, įskaitant, kokias apimtims kosmetikos priemonės konkuruoja su alkoholiniais gėrimais, kaip privataus verslo veiklą lemia vartotojų įpročiai naudoti gaminamus produktus ir kiek valstybė gali kištis į šią sritį.

**Pagrindiniai žodžiai:** ES teisė, akcizai, atleidimas nuo akcizo, atleidimo nuo mokesčio atvejai, „žmonėms vartoti neskirti produktai“, vartotojų įpročiai, kosmetika.

## Introduction

The functioning of the internal market implies the free movement of goods that entails the elements of mutual recognition and harmonized regulations.<sup>1</sup> Both in cases of imposing excise duties and granting exemptions the EU law provides for a certain level of harmonization to avoid distortions in competition.<sup>2</sup> Art. 27.1(b) of the Directive 92/83/EEC (hereinafter – Directive 92/83, Directive)<sup>3</sup> provides that Member States shall exempt certain products from excise duty if they are both denatured in accordance with the requirements of any Member State and used for the manufacture of any product not for human consumption. Thus, the exception of excise duties consists of two cumulative conditions. Moreover, when applied to a single Member State, the relief of excise duties must be respected in all States.

The recent case *Bene Factum* before the Court of Justice of the European Union (CJEU) considered the proper application of the Directive and the relief of excise duties, and the “not for human consumption” clause was put into question. Disputed mouthwash and cosmetics (hereinafter – the Disputed Products) were not intended for human consumption; however, they were consumed (ingested) by individuals, and the trader consciously tailored the supply according to the consumer behavior (the latter facts were not disputed).<sup>4</sup> Lithuania’s State Tax Inspectorate withdrew the excise duty exemption, arguing that the Disputed Products were intended for human consumption, moreover, the trader knowingly exploited this situation, and that, therefore, the products were subject to excise duty.<sup>5</sup> The Inspectorate raised two grounds for levying excise duties on the Disputed Products: consumer behavior (subjective competition of products) and the behavior of the manufacturer.<sup>6</sup> These criteria are not covered by the Directive, whereas the Lithuanian State Tax Authorities essentially argued that in this instance the principle of substance over form must be applied.<sup>7</sup>

The problem raised in the article is related to the determination of the use of the product in the context of the Directive when evaluating surrogate products, i.e., whether the use of the product is determined by its intent, or by the *de facto* use of the product, as this determination directly implies the applicable excise taxes.

The aim of the article is to determine the relevance of consumer behavior and competition of products when levying excise duties or relief thereof with regard to alcohol surrogate products. Accordingly, the tasks of the research are as follows:

1. To determine the scope of the levying of excise duties to products that contain denatured alcohol and are not intended for human consumption under EU law and case-law.
2. To identify the developed elements of a product that is not for human use under relevant EU laws and case-law.

<sup>1</sup> Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC, *OJ L 9, 14.1.2009, p. 12–30, preamble*.

<sup>2</sup> <sup>e</sup> European Commission. *Report from the Commission to the Council on the evaluation of Council Directive 92/83/EEC on the Structures of Excise Duties on Alcohol and Alcoholic Beverages COM(2016) 676*, p. 3, 5.

<sup>3</sup> Council Directive 92/83/EEC of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages. *Official Journal L 316*, 31/10/1992, p. 21–27.

<sup>4</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], *ECLI:EU:C:2019:158*, paras. 9–13, 19.

<sup>5</sup> Supreme Court of the Republic of Lithuania. *Ruling of 18 September, 2017 of the Supreme Court of the Republic of Lithuania in administrative case No. eA-736-556/2017*; Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], *ECLI:EU:C:2019:158*, para. 17.

<sup>6</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], *ECLI:EU:C:2019:158*, paras. 13–14.

<sup>7</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], *ECLI:EU:C:2019:158*, para. 15.

3. To analyze the relevance of economic market-based criteria for determining the application of excise duties in the light of the principle of substance over form raised by the State Tax Inspectorate in case C-567/17.

The relevance of the research is based on several legal problems arising both from the case arguments presented in *Bene Factum* and the possible outcomes of the case showing that the due application of Directive 92/83 raises questions that are yet to be answered. Consuming alcohol not originally intended for human consumption may pose health risks due to toxic denaturants or additives.<sup>8</sup> However, introducing excise taxes may create significant economic effects of raising the prices for ordinary consumers and reducing volumes of legal production.<sup>9</sup> A study found that the consumption of counterfeit alcoholic beverages also occurs when diluted technical spirits, such as screen wash or antifreeze, which were brought legally, are consumed for intoxication<sup>10</sup>; however, none of its components are either banned or subject to excise taxes. The gravity of the effects of the *Bene Factum* ruling, the substantial arguments presented during the case show an incoherence on the rules of levying excise duties and relief, and, in a broad sense, puts the limits of EU member state discretion in question. Based on the latter, the research on the legal and economic grounds and implications of the novel consumer behavior argument presented in *Bene Factum* may have significant impact in cases to come.

The topic of the article has not been analyzed by legal scholars. General informational publications may be found online.<sup>11</sup> The research is based on EU primary and secondary law, CJEU case-law, WTO primary law, WTO dispute settlement body reports, supplementary EU documents.

The following theoretical and empirical scientific research methods are applied. The document analysis method is employed to collect primary data, to analyze the provisions of relevant agreements, reports, and other relevant sources. The method of a systemic analysis and classification is employed to divide the object of the research, its purpose and tasks into components, as well as to assess the internal structure of relevant documents, their interaction with each other in order to identify the complexity of the topic and its most significant aspects. The logical analysis method is used to identify, associate, and generalize the material of the research, to evaluate the relevant aspects of legal documents and economic data, its interpretation possibilities, and the reasonableness and consistency of the research problem. A case-study is conducted to outline the possible model of categorizing alcohol surrogates for fiscal purposes.

## 1. The Scope of Levying Excise Duties on Cosmetics and Relief Thereof

The State Tax Inspectorate unilaterally assumed the purpose of the product based on the assumption that the product may be ingested by some individuals that was contrary to the intended use declared by the trader.<sup>12</sup> The following chapter analyzes the possibility of national state authorities to take such measures in determining excise taxes.

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<sup>8</sup> LACHENMEIER, D. W. Unrecorded and illicit alcohol in *Alcohol in the European Union*, WHO Regional Office for Europe, p. 29.

<sup>9</sup> *Ekonominės konsultacijos ir tyrimai, Mokesčių ir verslo procesų administravimo centras*. Akcizų mokestis Lietuvoje (*Excise Tax in Lithuania* [interactive], 2015 [accessed 29 August, 2019]. Available online: <[https://www.ekt.lt/wp-content/uploads/2015/05/Studija\\_Akcizo-mokestis-Lietuvoje-2015.pdf](https://www.ekt.lt/wp-content/uploads/2015/05/Studija_Akcizo-mokestis-Lietuvoje-2015.pdf)>.

<sup>10</sup> *Ibid*, p. 73.

<sup>11</sup> WARD, M. Excise Duty: Your Christmas drink of choice, or perhaps not [interactive], 2018 [accessed 16 August, 2019]. Available online: <<https://www.marcusward.co/excise-duty-your-christmas-drink-of-choice-or-perhaps-not/>>.

<sup>12</sup> Supreme Court of the Republic of Lithuania. *Ruling of 18 September, 2017 of the Supreme Court of the Republic of Lithuania in administrative case No. eA-736-556/2017*.

According to Article 27 of the Directive, the state has the obligation to relieve a product if it meets the necessary requirements (“Member States shall exempt”) implying that exemption from excise duties is a general rule. Thus the revocation of the excise tax relief according to the Court of Justice is an exception.<sup>13</sup> Moreover, the variation between the Member States in recognizing denaturing methods distorts the functioning of the internal market by influencing business decisions and competition between economic operators.<sup>14</sup>

According to the practice of the Court of Justice, the exemption or refusal of it depends on the denaturing method and whether it is approved in the Member State of origin.<sup>15</sup> Such an interpretation of the relief of excise duties would imply that the supplier has the right to request the relief of excise duties if the prescribed conditions are met.

Under the practice of the CJEU, the relief of excise duties in one Member State must be recognized in another Member State as the mutual recognition principle implies – any other interpretation would undermine the purpose of this Directive and impede the free movement of goods.<sup>16</sup> Moreover, the relief of excise duties under the Directive is a general principle, whereas the revocation of the relief of excise duties is an exception.<sup>17</sup>

Moreover, the Member State does not enjoy unlimited discretion in refusing excise duty relief. The measure applied by the country (i.e., to refuse excise duty relief) is subject to monitoring by the other Member States and EU institutions.<sup>18</sup> The Member State may refuse to grant tax relief or withdraw the relief already granted if it “finds that a product which has been exempted [...] gives rise to evasion, avoidance or abuse.” Yet this formulations leaves unanswered questions. The article itself does not give clarifications on whether a mere subjective assumption is enough or does the state have to prove its position. The CJEU has clarified that a refusal to grant the relief of excise duties cannot deny the unconditional nature of the duty to exempt provided for in that provision.<sup>19</sup>

The Lithuanian version of the Directive implies that the Member State has to establish or determine the rise for abuse, meaning that to a certain extent, the grounds for evasion, avoidance, or abuse have to be proven. Moreover, “gives rise” (i.e., intentionally not formulated as “may give rise”) implies that the grounds for evasion or abuse must be existing as a fact and determined at a certain level. This is supported by the statement that the Directive establishes a general rule that the state grants excise tax relief if conditions are met, thus implying that a mere assumption does not suffice to refuse or withdraw the relief of excise duties.

<sup>13</sup> Court of Justice of the European Union. *Judgment in case C-482/98 Italian Republic v Commission of the European Communities* [2000] EU:C:2000:672, para. 50.

<sup>14</sup> European Commission. *Case Study Report: Exemptions for denatured alcohol* [interactive], 2016 [accessed 29 August, 2019]. Available online: <<https://circabc.europa.eu/sd/a/ac02b54d-f95a-4ca4-97a9-3b4cf60dccb4/Appendix%208%20-%20In-depth%20case%20study%20on%20management%20of%20exemptions%20for%20denatured%20alcohol.pdf>>.

<sup>15</sup> Court of Justice of the European Union. *Judgment in case C-482/98 Italian Republic v Commission of the European Communities* [2000] EU:C:2000:672, para. 41.

<sup>16</sup> Court of Justice of the European Union. *Judgment in case C-163/09 Repertoire Culinaire*, [2010] ECLI:EU:C:2010:752, p. 38-42.

<sup>17</sup> Court of Justice of the European Union. *Judgment in case C-63/06 Profisa*, [2007] ECLI:EU:C:2007:233, p. 18.

<sup>18</sup> Court of Justice of the European Union. *Judgment in case C-482/98 Italian Republic v Commission of the European Communities* [2000] EU:C:2000:672, para. 51.

<sup>19</sup> Court of Justice of the European Union. *Judgment in case C-163/09 Repertoire Culinaire*, [2010] ECLI:EU:C:2010:752, p. 50, 52.

Lastly, as stated in the practice of the Court, the Directive and its interpretation implies that the Member State must put forward, at the very least, concrete evidence of a serious risk of evasion, avoidance, or abuse.<sup>20</sup> Thus, the burden of proof lies in the domain of the concerned Member State.

In the *Bene Factum* case, the State Tax Inspectorate and the referring court claim that the respondent “knew or must have known” that a part of the society consumes the cosmetics products not according to their original purpose. Yet in the case no substantial proof has been discussed or provided. The State Tax Inspectorate claim that product placement and the assumption that a certain part of the society may ingest the cosmetics as alcoholic beverages are sufficient grounds to qualify mouthwash and cosmetic spirit as alcoholic beverages.

In light of the ongoing debate, it must be emphasized that importing products for commercial reasons under EU law shifts the competence of taxing the products onto the authorities of Lithuania; however, this does not affect the exemption from tax duties, because under Lithuanian regulations, the exemption for excise duties granted in another Member State are recognized and respected under Lithuanian law.<sup>21</sup> The unilateral actions of a Member State have exponential outcomes and disrupt the internal market. Under Article 33 of Directive 2008/118/EC,<sup>22</sup> where goods are subject to excise duties in one Member State and are imported into another for commercial purposes, the goods shall be subject to excise duties in that State of destination. Accordingly, if mouthwash was subjected to excise duties in Lithuania, Poland and other countries that distribute the items would have the obligation of levying excise duties. Moreover, the exemption from excise duties as applied in Poland must be recognized by other Member States to ensure the uniform application of Directive 92/83.<sup>23</sup>

Regardless the ongoing debates in Lithuania (the dispute reached the Supreme Administrative Court) and controversial arguments provided by the Member States in *Bene Factum*, the CJEU was rather straightforward, reinstating the exemption from excise duties as a general rule and leaving minimal room for interpretations.<sup>24</sup>

## 2. The Use of the Product in Determining Applicable Excise Duties and the Scope of the Concept

Generally, EU law establishes that products must be categorized and taxed accordingly based on their intended use. However in the *Bene Factum* case two participating Member States and the representatives of Lithuania’s Government state that the actual use of the product must be the determining factor. The Advocate General contested by arguing that the intended use of the product must be the determining factor and not the actual or potential actual use of the products other than their intended use.<sup>25</sup>

The interpretation of Article 27 para. 1 “b” Directive 92/83/EEC (“not for human consumption”) may be disputed. It may seem that there is a lack of clarification on whether the products are not *in-*

<sup>20</sup> *Ibid*, para. 52.

<sup>21</sup> Lietuvos Respublikos Vyriausybės nutarimas dėl denatūruoto etilo alkoholio, kuriam netaikomi akcizai [The Decision of the Government of the Republic of Lithuania On Denatured Ethyl Alcohol that is exempted from excise duties], para. 3.3. *Valstybės žinios*, 2002-06-19, Nr. 60-2463.

<sup>22</sup> Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC. *OJ L 9, 14.1.2009*, p. 12–30.

<sup>23</sup> Court of Justice of the European Union. *The Opinion of 28 November, 2018 of the Advocate General Manuel Campos Sánchez-Bordona in case C-567/17*, para. 25.

<sup>24</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], ECLI:EU:C:2019:158,

<sup>25</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], ECLI:EU:C:2019:158, para. 24.

*tended* for human consumption, perhaps not *suitable* for human consumption, or not *used* for human consumption. From a linguistics standpoint, the flexible interpretation of “not for human consumption” significantly affects the scope of liability of the trader. The seemingly minor linguistic difference may significantly alter the interpretation and application of the whole exemption from excise duties, and the shift between the responsibility of the state and private party (manufacturer and (or) supplier). Take, for example, a case where the products are not *intended* for human consumption – the responsibility of the producer or supplier may be restricted to providing adequate information on the use of the product. And given that this information would be provided, the actual use of the product should not be the concern of the supplier. Meaning the latter is entitled to excise tax relief. In this case, even the expression *to consume* may be put into context. As noted by the Advocate General,<sup>26</sup> “to consume” may mean “to ingest (to swallow).”

In light of the uncertainty created by the wording of Article 27.1 (b), the Commission’s Indirect Tax Expert Group has issued an opinion on the interpretation of the term “used for the manufacture of any product not for human consumption.” The opinion emphasized that it is essential that a denaturing substance was intentionally added to the product at issue.<sup>27</sup> It was also laid down that in order to be exempted from excise duty, a product needs to be in its recognizable, finished form, held out for sale in that recognizable finished form and must contain denatured alcohol, which has been directly used in its manufacture.<sup>28</sup> Accordingly, the products that are not yet in their recognizable finished product form cannot benefit from the exemption from excise duties under Article 27 (1) (b) of Directive 92/83. Thus, in order to grant excise duty exemptions, it is necessary to determine whether the product is in its final, recognizable form (for example, perfume in a 50 ml flacon, screen-wash in a 5 liter retail container, clearly labelled and marketed/sold as such, whereas products moved in bulk are not entitled to exemptions).<sup>29</sup> In a relevant case study, it was found that Member States referred to the fact that only alcohol which is intended to be consumed by humans should be subject to excise duty.<sup>30</sup>

Moreover, under relevant CJEU practice, the exemption of excise duties must be granted based on objective circumstances in cases when “the use for which it is really intended does not correspond with the name assigned to it by the trader.”<sup>31</sup>

In the context of the case, the crucial argument is that the supplier provided sufficient information on the label of the products so that the consumers would be able to make individual decisions on the consumption of the products (in particular marking the use, ingredients, and purpose of the Products on their labels as finished recognizable products).

In making its judgement, the CJEU emphasizes the knowledge of the consumers and them being duly informed. The Court noted that the individuals who bought them as alcoholic beverages knew or

<sup>26</sup> Court of Justice of the European Union. *The Opinion of 28 November, 2018 of the Advocate General Manuel Campos Sánchez-Bordona in case C-567/17*, ff. 10.

<sup>27</sup> European Commission. Indirect Tax Expert Group (ITEG). *Opinion 1/2014 - Interpretation of the term “used for the manufacture of any product not for human consumption” in Article 27 (1) (b) of Council Directive 92/83/EEC* [interactive], 2014, p. 2-3 [accessed 16 August, 2019]. Available online: <[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/docs/body/opinions\\_2014\\_p\\_denatured\\_alcohol.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/opinions_2014_p_denatured_alcohol.pdf)>.

<sup>28</sup> *Ibid.*

<sup>29</sup> European Commission. *Case Study Report: Exemptions for denatured alcohol* [interactive], 2016 [accessed 29 August, 2019]. Available online: <<https://circabc.europa.eu/sd/a/ac02b54d-f95a-4ca4-97a9-3b4cf60dccb4/Appendix%208%20-%20In-depth%20case%20study%20on%20management%20of%20exemptions%20for%20denatured%20alcohol.pdf>>.

<sup>30</sup> *Ibid.*

<sup>31</sup> Court of Justice of the European Union. *Judgment in case C-482/98 Italian Republic v Commission of the European Communities* [2000] EU:C:2000:672, para. 42.

should have known that they were buying cosmetics or mouthwash products<sup>32</sup>; thus, the responsibility of the end use is shifted from the producer to the consumers to the extent that adequate information is provided.

It is noteworthy that after the examinations of the packages of the Disputed Products, it may be assumed that they are not only sold in Poland and Lithuania, but they are also imported into Estonia, as the name of the product and its description is provided in Estonian as well. Rather peculiarly, neither Estonia nor Poland provided their positions in the *Bene Factum* case, raising initial doubts on the arguments of Lithuania's Government as to whether the Disputed Products raise the outlined risks and whether they should be regarded as alcoholic beverages and (or) not exempted from excise tax duties.

### 3. Case Study of Market-Based Criteria for Determining the Application of Excise Duties on Surrogate Products

Surrogate products, such as the Disputed Products, give rise to the question whether formal criteria under the Directive are sufficient in determining the actual market situation. In the light of the latter, Lithuania's Tax Inspectorate relied on the principle of substance over form and claimed that consumer use and trader behavior arguments play a role in determining applicable excise taxes. However, such criteria are not covered by the relevant Directive. Thus, the article suggests analyzing the additional criteria raised by the parties in the light of WTO law, where such criteria are applied when determining the applicable fiscal regime on products.

#### 3.1. Objective Properties of Products as Determining Factors

Under EU regulations the classification of products depends on the objective properties of the product. The objective properties of the products may include the manufacturer's declared use of the product (labelling) and laboratory tests based on which the products are categorized (in the case of *Bene Factum* as cosmetics).<sup>33</sup> The objective qualities of the products include the technological preparation of the product, its smell, taste, additional ingredients, form, and presentation (external visual qualities), all of which must be taken into consideration.

According to settled EU case-law, in the interests of legal certainty and ease of verification, the decisive criterion for the classification of goods for customs tariff purposes is their objective characteristics and properties as defined in the wording of the relevant Combined Nomenclature and of the notes to the sections or chapters.<sup>34</sup> As regards the classification of such products, any reference in a heading to a material or substance is to be taken to include a reference to mixtures or combinations of that material or substance with other materials or substances that come under different tariff headings.<sup>35</sup> Mouthwash and cosmetic alcohol are based on denatured alcohol. Alcohol denaturation is the process of making alcohol unsuitable for human consumption and that it would not be possible to re-convert it

<sup>32</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], ECLI:EU:C:2019:158, para. 24.

<sup>33</sup> Council Regulation (EEC) No 2658/87 of 23 July 1987 on the tariff and statistical nomenclature and on the Common Customs Tariff, OJL 256, 7.9.1987, p. 1–675.

<sup>34</sup> Court of Justice of the European Union. *Judgment in case C-396/02 DFDS* [2004] ECR I-8439, para. 27; Court of Justice of the European Union. *Judgment in case C-445/04 Possehl Erzkontor* [2005] ECR I 0000, para. 19.

<sup>35</sup> Court of Justice of the European Union. *Judgment in case C-150/08, Siebrand BV v Staatssecretaris van Financiën* [2009] EU:C:2009:294, para. 34.

for use in food products.<sup>36</sup> Alcohol is made non-suitable for human consumption by adding very bad tasting and/or smelling products and a chemical marker.<sup>37</sup> The requirements regarding the technological process of the Disputed Products were duly met.

The ingredients of *Bene Factum* cosmetics were not disputed in the national cases; however, they might have significantly affected the final decisions in terms of its qualification. It must be taken into consideration that the disputed mouthwash (which was deemed as an alcoholic beverage by the national authorities) includes the *calendula officinalis* extract and glycerine, which are not used in producing alcoholic beverages. Most importantly, the mouthwash contains *chlorhexidine digluconate*, which is a disinfectant and antiseptic specifically common for mouthwash and cosmetic products.

The Court has also established that the intended use of a product may constitute an objective criterion for classification if it is inherent to the product, and that inherent character must be capable of being assessed on the basis of the product's objective characteristics and properties.<sup>38</sup> As it has been developed in the prior section, the intended use of the products was clearly established on the packaging of the Disputed Products, emphasizing their hygienic purposes. The CJEU held this to be the determining factor and declared that the knowledge that the products are consumed as alcoholic beverages by some and the aim to promote sales to this extent did not alter the presentation of the products as cosmetics that were subject to the relief of excise duties.<sup>39</sup>

Moreover, the CJEU consistently holds that taste can constitute an objective characteristic or property of a product.<sup>40</sup> The Lithuanian Tax Inspectorate and the referring court emphasize the importance of taste (smell) additives in the cosmetics products in deeming them as alcoholic beverages. It is well-established that alcoholic beverages may be infused with additives that create a certain smell and taste of the product. Generally perfumes or taste additives are included to make the product more marketable, and it is a widely established practice. As mentioned before, the denaturation process implies that the taste of the product may be unbearable even for rinsing. Thus, manufacturers introduce taste and smell additives. In cases of mouthwash products, the smell and taste properties are equally important, as mouthwash products are both smelled and tasted. Aroma additives are quite typical in mouthwash products, for example, menthol, eucalyptus, fruits. Thus, this characteristic is not the deciding factor.

### 3.2. Competitiveness of Cosmetics and Alcoholic Beverages

*In Bene Factum*, the Czech Republic raised the question of competitiveness of the Disputed Products and alcoholic beverages arguing that in the interest of fair competition, the Disputed Product must be taxed as alcoholic beverages.<sup>41</sup> Economic market-based grounds in the *Bene Factum* case may have led to different conclusions, as it was not argued by the parties of the dispute that indeed some consumers viewed the mouthwash and alcoholic beverages as substitutes based on their certain qualities.

<sup>36</sup> Court of Justice of the European Union. *Judgment in case C-503/10 Evroetil AD v Direktor na Agentsia "Mitnitsi"* [2011] ECLI:EU:C:2011:872, para. 60.

<sup>37</sup> *Ibid.*

<sup>38</sup> Court of Justice of the European Union. *Judgment in case C-459/93 Thyssen Haniel Logistic* [1995] ECR I 1381, para. 13; Court of Justice of the European Union. *Judgment in case C-396/02 DFDS* [2004] ECR I-8439, para. 29; Court of Justice of the European Union. *Judgment in case C-183/06 RUMA* [2007] ECR I 1559, para. 36; Court of Justice of the European Union. *Judgment in case C-150/08, Siebrand BV v Staatssecretaris van Financiën* [2009] EU:C:2009:294, para. 34.

<sup>39</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], ECLI:EU:C:2019:158, para. 32.

<sup>40</sup> Court of Justice of the European Union. *Judgment in case C-124/03 Artrada and Others* [2004] ECR I 10297, para. 41; Court of Justice of the European Union. *Judgment in case C-196/05 Sachsenmilch* [2006] ECR I 5161, para. 37.

<sup>41</sup> Court of Justice of the European Union. *The Opinion of 28 November, 2018 of the Advocate General Manuel Campos Sánchez-Bordona in case C-567/17*, paras. 28-29.



However, two conditions are neglected by the party's argument on fair competition. First, it is the level of similarity between the products and, second, the level of competitiveness between the products. The EU has also raised questions on levying excise duties on alcoholic beverages in terms of their competitiveness in earlier practice<sup>42</sup>; however, this side of the argument was neglected in the *Bene Factum* decision.

An assessment of the competitiveness of the disputed products may provide insight in determining whether the disputed product competed not with cosmetic products but with alcoholic beverages. Determining the competitiveness of products requires a comparison of the products based on certain properties (*tertium comparationis*). For the purpose of providing comprehensive analyses, the article includes the practice on assessing product competitiveness conducted by the WTO Dispute Settlement Body (hereinafter – DSB) and analyzes the possible *tertium comparationis* of cosmetics and alcoholic beverages.

For taxation purposes, WTO law establishes “like” products as a subset of directly competitive or substitutable products. According to the Report of the Working Party on Border Tax Adjustments, even though the products should be assessed in a case-by-case basis, the key criterion in determining the similarity of products may include the product's end-uses in a given market; consumers' tastes and habits, which change from country to country; the product's properties, nature, and quality.<sup>43</sup> The general concept is an assessment of whether there is a direct competitive relationship between two products or groups of products requires evidence that consumers consider or could consider the two products or groups of products as alternative ways of satisfying a particular need or taste in a sense whether they are interchangeable and the elasticity of such substitution is significant,<sup>44</sup> whereas common end-uses as shown by elasticity of substitution.<sup>45</sup>

However, the CJEU has established that for the purpose of measuring the possible degree of substitution. The Court discussed whether certain products meet or may meet (possible substitution) identical needs, thus allowing to assume that the latter factor must be taken into consideration. However in determining the substitution between wine and beer, the Court rules that attention should not be confined to consumer habits in a Member State or in a given region. The habits are essentially variable in time and space and thus they cannot be considered to be immutable. Thus, the tax policy of a Member State must not crystallize the given consumer habits so as to consolidate an advantage acquired by national industries concerned to respond to them.<sup>46</sup>

In determining the substitutability of beer and wine the CJEU has outlined the importance in the differences of the manufacturing of the regarded products. It noted that the *great differences between wine and beer from the point of view of the manufacturing processes and the natural properties of those beverages must be recognized*.<sup>47</sup>

Given the objective differences in the technological production of the Disputed Products, their ingredients, effects on the consumers, the objective competition of the products, and their interchange-

<sup>42</sup> Court of Justice of the European Union. *Judgment in case 170/78 Commission v United Kingdom [1983] ECR 2265*.

<sup>43</sup> Report of the Working Party on *Border Tax Adjustments*, BISD 18S/97, para. 18

<sup>44</sup> See e.g. WTO Panel. *Panel report in Korea – Taxes on Alcoholic Beverages, WT/DS75/R ; WT/DS84/R*. para. 10.40; WTO Appellate Body. *Report of the Appellate Body in Korea – Taxes on Alcoholic Beverages, AB-1998-7*, p. 15–33; Report of the Appellate Body, *Japan – Alcoholic Beverages II*, ff. No. 20.

<sup>45</sup> WTO Appellate Body. *Report of the Appellate Body in Korea – Taxes on Alcoholic Beverages, AB-1998-7*, p. 25.

<sup>46</sup> Court of Justice of the European Union. *Judgment in case 170/78 Commission v United Kingdom [1983] ECR 2265*, para. 14.

<sup>47</sup> *Ibid*, para. 15.

ability are minimal, if any. In this sense, it is arguable whether the increase in alcoholic beverage prices would force the majority of the consumers to opt for mouthwash or cosmetic spirit.

Under the established practice of the application of WTO law, the competitive conditions in the regarded national market should be taken into consideration,<sup>48</sup> because in various markets, consumer behavior may differ.<sup>49</sup> However, when it is necessary, the markets of other countries may be also taken into consideration if the markets are similar to at least some extent.<sup>50</sup> As mentioned, the Disputed Products are manufactured and sold in Poland, where they are relieved of excise duties. The issue of misuse of the products in Poland has not been raised in the case. The packaging of the Disputed Products also includes its description in Estonian; however, Estonia did not provide arguments in the case *Bene Factum*, raising the doubt whether the problem of improper use of the Disputed Products occurs in Estonia.

*Due to the denatured alcohol in the composition of the Disputed Products, their use cause similar effect as of alcoholic beverages (intoxication). However, as outlined in the main proceeding of the case, the problem of the misuse of the products only occurs in a small portion of the society. Also, given the labelling of the Disputed Products, it may be stated that the segment of the consumers intentionally decide on consuming the Products for purpose other than their intended original use.*<sup>51</sup> In light of the aforementioned and the line of arguments before the CJEU, the Disputed Products may be also declared equally competitive and interchangeable with antifreeze, liquid screen wash, or perfumes, thus suggesting that the line of arguments regarding the competitiveness is unfounded and unreasonable.

### 3.3. The Behavior of the Importer in Determining the Applicable Taxes

The State Tax Inspectorate argued that *Bene Factum* had failed to take any measure to prevent the products which it imported from being consumed as alcoholic beverage; moreover, the trader intentionally took the fact that some consume the Disputed Products into account, thus implying the application of excise taxes.<sup>52</sup> From the referral, it is evident that the State Tax Inspectorate argues that the packaging and labelling of the product must be taken into consideration as elements of the behavior of the seller; it may also include means of sale.<sup>53</sup> Regarding the packaging, the intent of the labelling was questioned, for example, in the indication of the alcoholic strength as a percentage and its purposes.

The element of trader behavior is not covered by the Directive nor is it a determinant under International trade law. Therefore, in order to determine the limits of the responsibility of the trader and the applicable taxes, it is necessary to analyze the applicable requirements and their limits.

The suppliers have the general obligation to ensure product safety and to provide the market with safe to use products.<sup>54</sup> It may be assumed, that the responsibility of providing safe to use products is limited to ensuring the safety of the product when used according to its original purpose. In order to ensure the appropriate use of the product, the manufacturers must label their produce accordingly, for

<sup>48</sup> WTO Appellate Body. *Report of the Appellate Body in Japan – Alcoholic Beverages II*, WT/DS8/AB/R, ff. No. 20.

<sup>49</sup> *Ibid*, ff. No. 16.

<sup>50</sup> WTO Appellate Body. *Report of the Appellate Body in Korea – Taxes on Alcoholic Beverages*, AB-1998-7, para. 137.

<sup>51</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], ECLI:EU:C:2019:158, para. 24.

<sup>52</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos* [2019], ECLI:EU:C:2019:158, paras. 13–14.

<sup>53</sup> *Ibid*, para. 28.

<sup>54</sup> Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety. *Official Journal* L 11, 15.1.2002, p. 4–17.

example, outlining the original purpose of the produce.<sup>55</sup> Thus, the responsibility of the trader is limited to providing information for the consumer to make a well-informed decision, for example, adding certain disclaimers on the products, the properties of the products, establishing that the product may be only used by its intended (original) purpose. The fact that the consumers were duly informed about the purpose of the Disputed Products was not disputed neither at the national, nor the EU judicial level.<sup>56</sup> This means that the consumer in fact made their own independent and informed decisions in purchasing the Disputed Products. In the line of the following, the responsibility of consuming products in a manner that is contrary to the original purpose of the products is the responsibility of the consumer, not the State, or the manufacturer, or the importer.

Moreover, in terms of cosmetics, the supplier can have no guarantee on the use of its products. Given the expiration date of cosmetic products, it would be illogical to hold the supplier responsible for the use of the products in the sense that consumer behavior patterns may change quite promptly. Moreover, it is well-established in the case that the supplier of the Disputed Products did not distribute the products to any particular market locations.<sup>57</sup>

Both the referring court of Lithuania and the State Tax Inspectorate outline that *Bene Factum* refused to denature the alcohol contents according to the regulations of Lithuania. However, this argument has minor legal value in the light of EU law, in particular the general principle of mutual recognition and the requirements for denaturation laid down in the regarded legal acts. According to Directive 92/83, a product is considered to be appropriately denatured if it meets the requirements of other member states. The fact that *Bene Factum*'s cosmetics were denatured under the rules of Poland were not disputed.

In *Bene Factum*, the referring court outlined that the importer in the case intentionally designed the packaging of the Disputed Products knowing that they may be consumed as alcoholic beverages by some individuals in order to promote the sales of the Disputed Products. This intention was regarded as one of the determinants of the decisions of the State Tax Inspectorate. However, the CJEU noted that regardless the actions and intentions of the importer, the products were presented as cosmetics or mouthwashes not intended for human consumption.<sup>58</sup> The Court placed the responsibility on the use of a product on the consumer as long as the trader has taken due measures to inform the consumers.

## Conclusions

1. In the interest of ensuring the proper functioning of the internal market, under the established case law, it is considered to be a general rule that a product must be exempted from excise duties if it is denatured under the regulations of another Member State and if the product is not intended for human use.
2. The definition of the Directive is not clear on whether in order to be exempted from excise duties the products must be not intended or not actually used (ingested) by the consumers. In the light of relevant EU law, its interpretations and the practice of the CJEU, a product is not for human use if it is not formally intended for human ingestion and as long as the consumer knew or should have known that the products were not to be ingested, and intentionally chose to ingest them knowing their original purpose.

<sup>55</sup> Regulation (EC) No 1223/2009 of the European Parliament and of the Council of 30 November 2009 on cosmetic products (Text with EEA relevance). *OJ L 342*, 22.12.2009, p. 59–209, Article 19.

<sup>56</sup> Supreme Court of the Republic of Lithuania. *Ruling of 18 September, 2017 of the Supreme Court of the Republic of Lithuania in administrative case No. eA-736-556/2017*.

<sup>57</sup> *Ibid.*

<sup>58</sup> Court of Justice of the European Union. *Judgment in case C-567/17, Bene Factum v. Valstybinė mokesčių inspekcija prie Lietuvos Respublikos finansų ministerijos [2019]*, ECLI:EU:C:2019:158, para. 29.

3. A more complex analysis in determining excise duties may prove to be beneficial when assessing the actual situation in the market regarding surrogate products. Under EU law, the responsibility of the trader is limited to providing the consumers with the information regarding the product regardless the actual intent and consequences. The study found that objective properties and economic *market-based criteria such as competition, consumer behavior, and trader behavior may provide insight on classifying products. The CJEU's decision in Bene Factum may be criticized in the sense that it legitimized overriding EU policies based on the formal criterion, ignoring the fact that the trader consciously made the decision to tailor its products to meet the consumer behavior of secondary use of products that may pose health risks.*

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### The Relevance of Consumer Behavior and Competition of Products to Levying Excise Duties on Cosmetics Under EU Law

**Karolina Mickutė**  
(Vilnius University)

#### S u m m a r y

Under EU law, products that contain denatured alcohol and are not for human use are exempted from excise duties; however, the application of these laws still raise questions. The *Bene Factum* case considered levying excise duties on cosmetics that were consumed as alcoholic beverages by some individuals, thus putting into question what and who determined the use of the product, i.e., the consumers or the trader.

EU law provides that the intended use of the product is the determining factor regardless whether some consumers might misuse it. Also, it is not relevant whether the supplier, keeping such misuse in mind, acted so as to increase the sale of those products.

### Vartotojų elgesio ir produktų konkurencijos reikšmė produktų apmokestinimo akcizo mokesčiu atvejais

**Karolina Mickutė**  
(Vilniaus universitetas)

#### S a n t r a u k a

Pagal ES teisę akcizo mokestis netaikomas produktams, kurie yra denatūruoti pagal vienos iš valstybių narių teisę ir nėra skirti žmonėms vartoti, tačiau praktikoje nuostatų taikymas kelia klausimų, konkrečiai – kaip, siekiant nustatyti akcizo mokestį, vertinamas produkto panaudojimas, t. y. pagal vartotojų elgesį ar pagal tiekėjo nustatytą produkto paskirtį.

ES teisė ir praktika rodo, kad produktas turi būti apmokestinamas ne pagal faktinį jo naudojimą, o pagal jo paskirtį. Tai, kad kai kurie vartotojai produktą vartoja ne pagal paskirtį, nėra lemiamas kriterijus. Tiekėjo elgesys šiuo požiūriu taip pat nėra svarbi aplinkybė.