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EXCISE DUTY ON TOBACCO AND NICOTINE-CONTAINING PRODUCTS: AWAITING REVISION OF EUROPEAN HARMONIZED STANDARDS



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The current excise taxation of traditional tobacco products in the EU, the practice of applying transitional periods to reach the current EU minimum excise duty on cigarettes, and approaches to the excise taxation of heated tobacco products in EU countries and Ukraine were examined. The changes proposed by the initiative to revise Council Directive 2011/64/EU were analyzed, with particular emphasis on the risk that their implementation could fuel the spread of illicit cigarette trade. The consequences of a sharp versus a gradual increase in the minimum excise duty on cigarettes in Ukraine were modeled. Proposals were developed to soften a number of requirements for the future excise taxation of tobacco and nicotine-containing products in the EU and to introduce appropriate excise duty rates in Ukraine.

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ЗМІСТ

EXECUTIVE SUMMARY 4

1. Excise taxation of traditional tobacco products in EU countries: status quo 11

2. Benefits and challenges of achieving the current European minimum excise duty level on cigarettes 15

2.1. Transitional periods and features of their application by EU countries ... 15

2.2. Excise duty increase schedules in Ukraine 20

3. Approaches to excise taxation of heated tobacco in the EU countries and Ukraine 24

4. European Commission proposal to revise the Council Directive 2011/64/EU 31

4.1. Changes provided by the updated version of European harmonized standards 31

4.2. Purchasing power parity and experience of its use in EU countries in other sectors 37

4.3. Risks of increasing the level of illicit cigarette trade 40

5. Recommendations on excise duty rates on tobacco and nicotine-containing products in Ukraine 48

5.1. Modeling the consequences of implementing the European Commission's initiative on cigarette taxation 48

5.2. Setting differentiated excise duty rates for different product categories ... 59

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EXECUTIVE SUMMARY

Excise taxation of cigarettes and other traditional tobacco products in EU countries: status quo

EU rules on excise taxation of tobacco products are currently defined by *the Council Directive 2011/64/EU of 21 June 2011* on the structure and rates of excise duty applied to manufactured tobacco (codification). Mentioned Directive *covers cigarettes, cigars and cigarillos, smoking tobacco*, but does not cover novel products – heated tobacco (electrically heated tobacco products, HTPs), liquids for electronic cigarettes (e-liquids), nicotine pouches, which appeared on the market after its adoption and were not included within its regulatory scope.

According to the Council Directive 2011/64/EU, the total amount of the excise duty on cigarettes must be at least 60% of the weighted average retail selling price. At the same time, this amount (minimum excise duty on cigarettes) must not be less than 90 euros per thousand units.

The Council Directive 2011/64/EU establishes the principle according to which ***different duty rates can be applied for each category of tobacco products, but the highest rate is defined for cigarettes***.

Today, the difference between the lowest EU minimum excise duty on cigarettes in Bulgaria and the highest in Ireland is about five times. At the same time, ***all EU countries have already "outgrown" the "90 euros" rule***.

What were the challenges in achieving the current European minimum excise duty on cigarettes and how were they overcome?

Even 10-15 years ago the situation was different. Despite the fact, that the minimum excise duty on cigarettes in the EU was increased to 90 euros per thousand units ***in 2014***, the Council Directive 2011/64/EU regulated ***exceptions*** for Bulgaria, Greece, Estonia, Latvia, Lithuania, Poland, Romania and Hungary, which were allowed to meet this standard *by* ***2018***. Bulgaria, Lithuania, Hungary and Croatia made the corresponding changes within the maximum time frame.

The schedules of excise increase on cigarettes in Central and Eastern European countries upon accession to the EU have been drafted for a long period, sometimes for 13-14 years. In addition, *in case of spread of illicit trade in tobacco products, governments quickly reacted by* ***suspending or slowing down tax increase***. The illicit cigarette market "exploded" in Bulgaria, Latvia, Lithuania and Hungary after too sharp increase of the minimum excise. This confirms the critical need for a transitional period to implement the "90 euros" rule.

An increase of the level of illicit cigarette trade with an increase in their excise duty rates was also seen in Ukraine. Despite the fact that the government introduced the schedules of the tax rates changes. The first seven-year plan introduced *the*

increase of the minimum excise duty on cigarettes ***by 20%*** per year until 2025 (except for 2018, when the rate increased by 30%). *In 2018-2025, such excise duty increased from 773.2 to 3019.85 hryvnias per thousand units*, which, taking into account the exchange rate at that time, corresponded to the level of 90 euros.

The increase of the minimum excise duty was accompanied by a decrease in the consumption of legal cigarettes in Ukraine from 65.1 billion units in 2017 to 26.4 billion units in 2025 and ***by a surge in illicit trade*** of such products from 2.3% in 2017 to 21.8% in 2023. In 2024, coordinated actions by the authorities, control bodies, and law enforcement agencies ensured a significant reduction of the illicit cigarette market to 16.1%, but during 2025, tobacco criminals could again partially expand their sphere of influence.

On March 25, 2025, has not yet been fully implemented plan of the excise duty increase on tobacco products in Ukraine for 2018-2025 was replaced by *a new four-year schedule* in euro, according to which *in 2025 the minimum excise duty on cigarettes must be* 78 euros per thousand units, ***in 2026 – 82 euros***, *in 2027 – 86 euros,* ***reaching eventually 90 euros in 2028***. In addition, as in 2024 the excise burden on cigarettes at the weighted average price did not reach the level of 60%, a norm came into force, which increased the minimum excise duty by 10% to ***85.8 euros per thousand units*** *from April 1 to December 31, 2025*.

A gradual increase of the minimum excise duty on cigarettes in Ukraine in 2026-2028 *is align with the approaches of the excise policy formation in Central and Eastern European countries* that have managed the spread of the illicit trade in tobacco products during their accession to the EU.

Approaches to excise taxation of heated tobacco in EU countries and Ukraine

Since the Council Directive 2011/64/EU does not cover heated tobacco products, EU countries can independently choose their approaches regarding defining the relevant excise duty. The European Commission recommended taxing these products at the same rate as it is applied on other smoking tobacco.

Currently, most EU countries (19) apply the excise duty on heated tobacco products per kilo of tobacco weight, ***and all member states have a lower excise duty on HTPs compared to cigarettes***. In 2025, among 24 countries analyzed by us ***the ratio of the excise duty on heated tobacco and cigarettes*** *ranged from 82.4% in Estonia to 15.9% in Hungary, while the average value of the mentioned indicator in the EU was* ***52.0%***. Spain, Germany and Portugal were not included to our sample, whose HTPs systems taxation do not allow to make correct comparisons.

In Ukraine, in 2016-2020 heated tobacco was taxed as an excise category of "tobacco substitutes", the excise rate for which is several times lower than for cigarettes. In 2021, the excise duty on HTPs became identical with the minimum excise

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duty on cigarettes, which from 2022 was accompanied by a reduction and then by a slow growth of the market of these novel products.

On March 25, 2025, the minimum excise duty on cigarettes increased to 78 euros per thousand units, and the excise rate on HTPs increased to 70.4 euros; the differentiation of the excise burden on these types of products was less than 10%. In addition, an increase in the excise duty rates for 2026-2028 was foreseen. The minimum excise duty on cigarettes will increase at a rate of about 5% per year in euros. The excise duty rate on HTPs should increase to 72 euros in 3 years. The changes mentioned are in line with the practice of EU countries. ***Starting from 2028, the excise duty differential on heated tobacco and cigarettes in Ukraine will be only 20%.***

HTPs market in Ukraine is developing totally in the legal segment, which confirms the increase of the excise duty amount paid from such products, which in 2025 amounted to 18.5 billion hryvnias. In return, the market of liquids for electronic cigarettes, which are becoming increasingly popular, is more than 90% illicit; e-liquids excise revenues amounted to about 0.5 billion hryvnias. *In wartime, it is especially important that the consumption of HTPs ensures the payment of all taxes stipulated by legislation.*

Initiative to revise Council Directive 2011/64/EU

On 16 July 2025, the European Commission published *the Proposal for a Council Directive on the structure and rates of excise duty applied to manufactured tobacco and tobacco related products (recast)* (hereinafter referred to as the Proposal). The document presents changes of the required minimum excise rates that should come into force from January 1, 2028, and some of them – in 2029-2032.

Considerable attention has been paid to revision both ***the rate of the minimum excise rates and the approach to their setting***. *In particular, from 2028 the minimum excise duty rate on* ***cigarettes*** *should increase to 215 euros per thousand units and* ***be adjusted to the price level index****. This means that* ***the single minimum rate at the EU level will be replaced by its national analogues*****,** while defining which will be considered the economic situation in the countries by adjusting the base rate on the Price Level Index (PLI) of the countries. PLI is calculated by Eurostat. 2/3 of the tax rate will be fixed, 1/3 will be adjusted based on the purchasing power parity of the countries.

Considering PLI for 2024, for *Bulgaria* the minimum excise duty on cigarettes will be *186.1 euros per thousand units*. In return, in Denmark this excise duty will be *245.9 euros per thousand units*.

The tax increase will also affect other traditional tobacco products. The excise duty rate on **cigars and cigarillos** will increase the most – in 2028-2032 the excise burden should increase by 12 times. Starting from 2030, **nicotine pouches** will be

taxed at *the same excise rate as* **other smoking tobacco and other processed tobacco**.

From January 1, 2032, *the minimum excise duty rate on* **heated tobacco** *will be 55% of the retail price or 108 euros per thousand units (155 euros per kg)*. The rates will be adjusted on *PLI*. ***The minimum excise burden on heated tobacco products in the EU will be half of cigarettes***. The harmonization of excise duty on heated tobacco also provides for a transitional period during 2028-2031. *A gradual transition to higher rates is proposed to avoid abrupt structural changes in the tobacco market.*

According to the Proposal provisions, already *from 2028*, two excise duty rates will be applied on **liquids for electronic cigarettes** in the EU depending on their nicotine content, which should be defined as a percentage of the retail price or as a fixed amount per 1 ml. ***Nicotine-free e-liquids will be included to the scope of the directive*** to limit tax evasion through "self-mixing" (when nicotine is added by consumers to nicotine-free liquids). *Differentiated excise duty rates for e-liquids can complicate tax administration and provoke abuse.*

Also, it is provided *introduction of a zero-excise duty rate on* **raw tobacco** *and its coverage by the EU Excise Movement Control System (EMCS)*.

Risks of increasing levels of illicit cigarette trade

A wide range of studies have been published, which have proven ***a close connection between the increase of the excise duty on cigarettes and the development of their illicit market***. Our analysis also showed that in 2021-2024, *some of the highest levels of illicit trade in tobacco products in the EU or their significant growth were observed in countries with the highest excise duties on cigarettes*. In addition, ***a sharp increase of the excise duty negatively affected the tobacco market and caused significant losses of budget revenues even in countries with high purchasing power of the population and institutional capacity of control bodies and law enforcement systems***.

Additional risks will arise from the implementation of the Proposal provisions on cigarettes excise taxation. Considering that *the minimum rates corresponding to the new requirements should come into force from 2028*, a sharp increase of the excise duty on cigarettes by 35-60 euros should occur in Lithuania, which is problematic in terms of illicit trade of such products, as well as in more prosperous in this context countries such as Sweden, Slovenia, Romania, Malta, Slovakia, Austria, Poland, Spain, Portugal. A number of other EU countries – Greece, Hungary, Cyprus, Croatia and Luxembourg – will be forced to make even more radical changes to rates, and Bulgaria will have to almost double its excise duty on cigarettes.

The high pace of the minimum excise increase on cigarettes in many EU countries will create a threat of ***surges in counterfeit production and smuggling of such***

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products *for these member states.* But such rates increase will not improve the situation for countries that already have high excise duties and suffer from the prevalence of illicit cigarettes.

For the EU accession candidates, most of which have a lower purchasing power than Romania or Croatia, *the risks of the spread of illicit cigarette trade will be even greater*.

Preventing such an undesirable situation is possible under the following conditions:

1. Postponement of coming into force introduction of the new minimum excise duty on cigarettes of "215 euros" to 2032.

2. Provide additional transitional periods for countries with low purchasing power.

3. Increase flexibility in the formula for calculating the minimum excise duty on tobacco and nicotine-containing products for better consideration of countries specifics (for example, in the least developed countries, not 1/3, but 1/2 of the rate may be adjusted on PLI).

It is possible to choose not one, but several of the proposed solutions.

Results of modelling the consequences of implementing the European Commission's initiative on cigarette taxation in Ukraine

Taking into account the adjustment on PLI, *the minimum excise duty on cigarettes* ***in Ukraine*** *may need another increase to approximately* ***180 euros*** *per thousand units in the future.* Namely, according to the Proposal's provisions, Ukraine will be forced to set the minimum excise duty on cigarettes at a level close to the current average European one.

Based on our projections, *if the scenario of increasing the minimum excise duty on cigarettes* ***to 180 euros per thousand units by 2028*** is implemented, Ukraine can expect a significant increase of the illicit cigarette market, reaching about 31.5% in 2028. Budget revenue losses from excise tax, VAT, and retail excise could reach about 40 billion hryvnias in 2026, 67 billion hryvnias in 2027, and 100 billion hryvnias in 2028; in total, *the budget may be undercounted by* ***more than 200 billion hryvnias***. Such a sharp increase in excise duty could also *accelerate the shift from cigarettes to illicit liquids for electronic cigarettes*, a trend that is currently difficult to control.

Instead, the scenario of *increasing the minimum excise duty on cigarettes in Ukraine* ***to 180 euros per thousand units from January 1, 2035***, when in 2028 such excise duty will reach the level of 90 euros per thousand units (as it is already stipulated by legislation), and then gradually double over seven years, will ensure a decrease in the smoking prevalence, stable growth in budget revenues, and create conditions for reducing the level of the illicit trade in tobacco products.

The soundness and consistency of the excise policy in the sphere of tobacco products in 2026-2028 will allow *to reduce the share of the illicit cigarette market to* ***10.4%*** in 2028. *Budget losses from such illicit cigarette market will decrease* from 26.5 billion hryvnias in 2025 to ***18 billion hryvnias*** in 2028. During this period, *the combat against illicit cigarettes should be intensified, and it is important to maintain the intensity of its efforts in 2029-2035.*

The approach to gradually increase of the minimum excise duty on cigarettes in Ukraine to 180 euros per thousand units from January 1, 2035 can ***be fixed*** either *by amending the relevant norms of the updated Directive*, supplementing the text of the Proposal, or *by incorporating the specified strategy of the excise policy in new agreements on Ukraine's accession to the EU*.

An alternative scenario for increasing the minimum excise duty on cigarettes in Ukraine would exist if ***changes were made to future EU legislation regarding the adjustment coefficient on the price level index***. For countries with PLI up to 75.0, half of the excise rate can be fixed (while in *the Proposal* 2/3), and the other half (as in *the Proposal* 1/3) could be adjusted based on the purchasing power parity.

Proposals on the excise duty rates on other tobacco and nicotine-containing products in Ukraine

There is ongoing discussion around the new excise duty rules initiated by the European Commission, during which a number of serious warnings were expressed on the implementation of requirements that apply not only to cigarettes, but also to other tobacco and nicotine-containing products.

Considering the Proposal requirements regarding adjusting rates on the price level index, ***in 2032*** *the excise duty on heated tobacco for Ukraine should be approximately* ***90.4 euros per thousand units***. Thus, in 2029-2032 excise rates for HTPs should *increase* ***by 18.4 euros***; it will be possible to increase this rate by 4.6 euros each year to reach the threshold of 90.4 euros per thousand units. This demonstrates Ukraine's *strong readiness to adopt upcoming EU regulations and shows that* ***a reasonable increase in excise duty on HTPs is achievable***.

In 2025, Ukraine's excise duty rate on heated tobacco products exceeded the corresponding rate in 13 EU countries. Meeting the requirements of the Proposal regarding HTPs will cause significant challenges for several of these countries.

In Ukraine, it is important to avoid a significant price gap between completely legal HTPs and more than 90% illicit liquids for electronic cigarettes. The lower excise duty on HTPs compared to cigarettes prevents heated tobacco consumers from choosing cheaper e-liquids. This is due to the threat of additional decrease of sales volume of legal tobacco and nicotine-containing products.

Ukraine ***is already complying*** with the proposed *requirements regarding the new minimum excise duty rates in the EU on* ***liquids for e-cigarettes***. ***It will be more***

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difficult to comply with the new taxation rules on nicotine pouches, cigars and cigarillos. At the same time, it is likely that a number of the Proposal provisions will be softened, and our state will demonstrate greater readiness on its fulfilment.

The best strategy for Ukraine today will be to adhere the current schedule of increasing excise duty rates on tobacco and nicotine-containing products for 2025-2028, and further changes in the excise policy should be initiated after the adoption of the final version of the updated EU Directive in mentioned area.

1. Excise taxation of traditional tobacco products in EU countries: status quo

The principles of EU policy in the excise duty on tobacco products are currently defined by the Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco (codification)[1]. It is aimed at achieving three goals (priorities): *ensuring a high level of public health protection; proper functioning of the internal market for excisable goods; filling the budgets of countries with tax revenues*.

The EU applies a common approach to the excise policy for tobacco products among member states, which involves setting of such tax rates that will ensure the main regulatory effect – reducing the consumption of these products. The mentioned directive introduces the basic principles for harmonizing the structure and rates of excise duty on tobacco products (manufactured tobacco).

According to Articles 3-5 of the Council Directive 2011/64/EU, which are devoted to the definition of excisable goods, manufactured tobacco is:

– *cigarettes;*

– *cigars and cigarillos;*

– *smoking tobacco:* 1) fine-cut tobacco for the rolling of cigarettes; 2) other smoking tobacco.

However, the Council Directive 2011/64/EU does not provide definitions of *heated tobacco (electrically heated tobacco products, HTPs), liquids for electronic cigarettes, nicotine pouches, etc.*, which appeared on the market after its adoption and were not included within its regulatory scope.

Article 7, paragraph 1 of the Council Directive 2011/64/EU states that cigarettes shall be subject to: 1) an ad valorem excise duty as a percentage of the maximum retail selling price inclusive of all taxes (custom duty may be disregarded); 2) a specific excise duty calculated per unit of the product. The maximum retail selling price shall be defined by the manufacturer or importer of cigarettes.

The ad valorem and specific excise duty rates should be the same for all types of cigarettes (Article 7, paragraph 2), and the percentage of the excise duty specific component in the amount of the total tax burden on cigarettes shall be defined based on the weighted average retail selling price (Article 8, paragraph 1). This price is calculated by dividing the total value of all produced cigarettes in the previous year (considering their maximum retail selling price, including all taxes) by their total quantity (Article 8, paragraph 2).

[1] On the structure and rates of excise duty applied to manufactured tobacco (codification). Council Directive 2011/64/EU of 21 June 2011. URL: http://www.minjust.gov.ua/45885.

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

It is possible to apply the minimum excise duty on cigarettes (Article 8, paragraph 6). Paragraph 2 of Article 10 of the Council Directive 2011/64/EU states that the total amount of the excise duty on cigarettes must be at least 60% of the weighted average retail selling price. At the same time, this amount must not be less than 90 euros per thousand units, regardless of the weighted average retail selling price. EU countries that charge the excise duty of at least 115 euros per thousand units may not comply with the 60% requirement.

As regards cigars, cigarillos and smoking tobacco, we will separately mention paragraph 3 of Article 14 of the Council Directive 2011/64/EU on the excise duty rates, which must be set without differentiation within each group according to quality, presentation, products origin, materials used in their production, manufacturer's specifications, etc.

The mentioned directive in addition provides that regarding these tobacco products the rates may be: either ad valorem (calculated on the basis of the maximum retail selling price); or expressed as fixed amount per kilogram (for cigars and cigarillos – as a fixed amount for a certain number of units of the product); or both, combining ad valorem and specific components. At the same time, in case of application of ad valorem or mixed rates to cigars, cigarillos and smoking tobacco, it is possible to set the minimum excise duty.

The amount of the excise duty shall be for: cigars or cigarillos – not less than 5% of the retail selling price, including all taxes, or 12 euros per thousand units or per kilogram; fine-cut tobacco for the rolling of cigarettes – not less than 50% of the weighted average retail selling price or 60 euros per kilogram; other smoking tobacco – not less than 20% of the retail selling price, including all taxes, or 22 euros per kilogram.

Thus, unlike cigarettes, quite broad taxation harmonization standards of other types of processed tobacco are applied, which specifies different approaches of EU countries to the choice of their tax bases. The Council Directive 2011/64/EU also provides ***the principle that different duty rates can be applied for each category of tobacco products, but the highest rate is provided for cigarettes***. This is clearly seen in the example of a comparison of the excise duty rates of EU countries on cigarettes and cigarillos.

As of October 1, 2025, 14 EU countries applied the specific or minimum excise duty on cigarillos per thousand units that was lower than the minimum excise duty on cigarettes (Table 1.1). ***The average level of differentiation of the corresponding excise burden was 49.7%.***

Table 1.1

Level of differentiation of the excise duty on cigarillos and cigarettes in certain EU countries in 2025*

Countries	**Minimum excise duty on cigarettes,** *euros per thousand units*	**Excise duty rate on cigarillos,** *euros per thousand units*	**Level rates difference %**
Austria	175	115**	34,2
Belgium	353,9	124,1**	64,9
Italy	209,3	92,5**	55,8
Spain	150	47**	68,7
Luxembourg	144,5	23,5**	83,7
Malta	165	25,2	84,7
Germany	241,6	75,1**	68,9
Romania	140,7	124	11,9
Slovenia	150	59**	60,7
Hungary	117,5	13,6**	88,4
France	378,8	302,6**	20,0
Croatia	124,2	120,5	3,0
The Czech Republic	182	108,7	40,3
Sweden	187,6	165,2	11,2
Average	**-**	**-**	**49,7**

* As of October 1, 2025, taking into account the current exchange rates of national currencies of countries that are not part of the eurozone

** Minimum excise duty

Source: European Commission. Taxes in Europe Database. URL: https://trade.ec.europa.eu/access-to-markets/en/content/excise-duties#toc_3

In Bulgaria, Denmark, Estonia and Latvia, the excise duty on cigarillos is also applied per thousand units, but it is higher than the minimum excise duty on cigarettes. In Finland, these excise duty rates are the same. In Greece, the Netherlands and Portugal, the excise duty rate on cigarillos is expressed as a percentage of the retail selling price, and in Ireland, Cyprus, Lithuania, Poland and Slovakia, it is expressed per kilogram of product. The corresponding excise duty rates are given in Table 1.2.

Such different national approaches to cigarillos taxation do not facilitate elimination of barriers for free movement of products within the EU. However, considering relatively low prevalence of use of such products, this does not pose a serious problem. In return, *the excise duty rates on **cigarettes** (the most popular tobacco product on the market) are more unified* and are in the focus of the European Commission's attention.

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Table 1.2

Excise duty rates on cigarettes and cigarillos in EU countries with differences from the most common approach to cigarillos taxation in 2025*

Countries	Minimum excise duty on cigarettes, *euros per thousand units*	Excise duty rate on cigarillos
Bulgaria	107,1	201,9 euros per thousand units
Estonia	186,7	244** euros per thousand units
Denmark	251,6	296,3** euros per thousand units
Latvia	171,9	202,7 euros per thousand units
Finland	389,6	389,6** euros per thousand units
Greece	117,5	35% of retail selling price
Netherlands	390,4	11% of retail selling price
Portugal	151,88	25% of retail selling price
Ireland	533,9	541,8 euros per kg
Cyprus	121,5	90 euros per kg
Lithuania	149,7	109,7 euros per kg
Poland	157,7	134,9 euros per kg
Slovakia	148	89,3 euros per kg

* As of October 1, 2025, taking into account the current exchange rates of national currencies of countries that are not part of the eurozone

** Minimum excise duty

Source: European Commission. Taxes in Europe Database. URL: https://trade.ec.europa.eu/access-to-markets/en/content/excise-duties#toc_3

Table 1.1 and Table 1.2 data illustrate that the minimum excise duty on cigarettes in Bulgaria is approximately 5 times lower than in Ireland, while the corresponding ratio for Greece and Ireland (both EU-15) is more than 4.5 times. Estonia, located in Central and Eastern Europe, has already gained highly developed Sweden regarding this indicator. In contrast, Bulgaria and Hungary, which are among the poorest EU countries, are the least inclined to increase the excise duty on cigarettes. In addition, ***EU countries have already "outgrown" the "90 euros" rule***, regarding which the European Commission has developed and submitted for public discussion a concept for its revision. More details in this regard are given in Subsection 4.1.

2. Benefits and challenges of achieving the current European minimum excise duty level on cigarettes

There is always a discrepancy between expectations from the implementation of the tax policy and real possibilities of influencing its measures on certain processes. It is especially evident in the context of a sharp increase in the excise rates on tobacco products, when instead of desirable reduction in consumption of such products and growth in budget revenues, the share of its illicit market may increase, which has the opposite consequences.

2.1. Transitional periods and features of their application by EU countries

The Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco (codification) defines harmonization principles of the structure and excise duty rates for traditional tobacco products, the most popular type of which during its adoption were and remain cigarettes today.

Article 10, paragraph 2 of the Council Directive 2011/64/EU defines that from 2014 the total amount of excise duty on cigarettes shall represent at least **60% of its weighted average price** (*WAP*). In addition, the minimum excise duty (*MED*) shall not be less than **90 euros per thousand units**, irrespective of the weighted average retail selling price. Countries that have applied the minimum excise duty of at least 115 euros per thousand units may not comply with 60% requirement.

Even though the Council Directive 2011/64/EU entered into force at the beginning of 2012, *the minimum excise duty on cigarettes in the EU was increased to 90 euros per thousand units* ***in 2014***. In addition, were introduced *exceptions provided for Bulgaria, Greece, Estonia, Latvia, Lithuania, Poland, Romania and Hungary*, which were allowed to reach 90 euros by ***2018***.

In case of non-compliance with “60% requirement” due to changes in the weighted average retail selling price of cigarettes, may be maintained established excise duty level until 1 January of the following year (Article 11, paragraph 1 of the Council Directive 2011/64/EU). However, after this date, compliance with this standard must be ensured.

Let’s consider implementation of such provisions of common European legislation in the EU countries of the former socialist camp, which are in Central and Eastern Europe.

The analysis of the dynamics of the minimum excise duty on cigarettes based on our sample of countries in 2012-2018 (Table 2.1) showed the following. If in 2012 this indicator reached 90 euros per thousand units only in Slovenia, then in 2014 there were four such countries – Estonia, Poland, Slovakia joined the leader. In 2016, MED on cigarettes even slightly exceeded the specified level also in Latvia,

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Romania, and the Czech Republic. The outsiders in achieving this harmonized standard were Bulgaria, Lithuania, Hungary, and Croatia, which made necessary changes within the maximum time frame. In 2018, in Estonia, Latvia, Slovenia, and the Czech Republic, the minimum excise duty exceeded 100 euros per thousand units.

Table 2.1

Dynamics of the minimum excise duty on cigarettes in EU countries located in Central and Eastern Europe, 2012-2018

Countries	Amount, euros per thousand units			
	2012	2014	2016	2018
Bulgaria	75,67	75,67	82,32	90,50
Estonia	80,00	90,00	97,20	115,38
Latvia	73,32	85,60	93,70	109,20
Lithuania	67,19	74,14	85,00	96,00
Poland	74,89	92,86	97,88	98,24
Romania	76,50	79,00	94,61	94,88
Slovakia	88,50	91,00	91,00	96,50
Slovenia	90,00	106,00	106,00	111,00
Hungary	75,72	84,14	89,51	93,76
Croatia	n	n	84,82	92,84
The Czech Republic	84,41	87,73	92,74	101,17

Source: European Commission. Taxes in Europe Database. URL: https://trade.ec.europa.eu/access-to-markets/en/content/excise-duties#toc_3

In addition, in 2018, only three of eleven analyzed EU countries (Croatia, Hungary, and Romania) had the excise duty share of less than 60% in the weighted average retail selling price of cigarettes (Table 2.2). These countries were required to catch up to standard by January 1, 2019.

However, in 2019, the European Commission went to the Court of Justice of the European Union[2] in connection with *failure to comply by* ***Hungary*** *60% requirement*. The country did not reach 60% excise duty threshold in the weighted average retail selling price of cigarettes not only in 2018, but also in subsequent years. An official letter notifying Hungary of this was sent from the European Commission on January 24, 2019, but the country had ignored it. As a result, the case was referred to the Court of Justice of the European Union. Although in 2018 were taken measures to force Hungary to raise the excise duty on cigarettes, the country refused to apply sharp and sudden excise duty increase. In addition, Hungary tried to convince the European Commission that more favorable excise taxation, which would consider the differences between the tax systems of EU countries and the different

[2] Taxation: Commission refers Hungary to the Court for failing to apply the minimum EU excise duty on cigarettes. European Commission - Press release. Brussels, 10 October 2019. URL: https://ec.europa.eu/commission/presscorner/api/files/document/print/fi/ip_19_5991/IP_19_5991_EN.pdf

income levels of their population, would be more appropriate. Instead, EU rules are ignored by the fact that countries on the EU's eastern borders have to combat against cigarette smuggling and its illicit trade in general.

Table 2.2

Taxes in the weighted average retail selling price of cigarettes in EU countries located in Central and Eastern Europe, in 2018

Countries	Weighted average retail selling price of a pack of cigarettes, euros	Share of the excise duty in the weighted average retail selling price of cigarettes, %	Share of the excise duty and VAT in the weighted average retail selling price of cigarettes, %
Bulgaria	2,57	68,43	85,09
Estonia	3,55	69,15	85,82
Latvia	3,20	66,63	83,99
Croatia	3,19	**59,91**	79,91
Poland	3,20	61,34	80,04
Lithuania	3,18	62,11	79,46
Slovenia	3,51	63,25	81,28
Slovakia	3,23	61,21	77,88
The Czech Republic	3,31	60,95	78,31
Hungary	3,59	**53,96**	75,22
Romania	3,46	**56,59**	72,56

Source: European Commission. Taxes in Europe Database. URL: https://trade.ec.europa.eu/access-to-markets/en/content/excise-duties#toc_3

In 2021, the Court of Justice of the European Union upheld mentioned claim of the European Commission regarding Hungary's failure to comply with the EU law[3]. The country, according to its government, has no room for maneuvering. It was initiated two stages increase of the excise duty on cigarettes: from January 2022 by 7.3% and from April by another 4.8% (only to comply with the minimum EU requirements).

In ***Romania*** the excise duty share in the weighted average retail selling price of cigarettes was already 61.01% in 2019, and in ***Croatia*** – 60.93%. Compliance with the relevant requirement of the Directive in these countries was ensured by a well-thought-out strategy of the gradual excise duty increase.

It should be noted that ***schedules of the excise increase on cigarettes upon accession to the EU***, which for most of the countries analyzed coincided with the entry into force of paragraph 2, Article 10 of the Council Directive 2011/64/EU,

[3] European court docket: Hungary doesn't adhere to the rise in tobacco excise tax. March 26, 2021. URL: http://tax-attorney.review/european-court-docket-hungary-doesnt-adhere-to-the-rise-in-tobacco-excise-tax/

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have been drafted for a long period, sometimes for 13-14 years. In addition, *in case of spread of the illicit trade in tobacco products, governments quickly reacted by* ***suspending or slowing down tax increase*** (Table 2.3).

Table 2.3

Experience of slowing down (suspending) the excise duty increase on cigarettes in some EU countries

Countries	Period, years	Change of the excise duty rate, %	Prerequisites	Effects
Bulgaria	2011-2015	0	The share of the illicit cigarette market increased to 30.7% in 2010. Budget revenues from the excise duty on tobacco products decreased by 15.4% in 2010.	It was possible to decrease the share of the illicit cigarette market to 6.8%. The excise revenues from tobacco products increased by 35%.
Latvia	2010-2013	10,1	In 2010 the share of the illicit cigarette market was 37.0%. In 2009 the amount of the excise duty revenues from tobacco products decreased by 21.8%, in 2010 by another 20.9%	During specified period, it was possible to reduce the level of the illicit cigarette trade by 8 percentage points. Since 2011 the growth of budget revenues has been restored.
Lithuania	2011-2014	10,4	The share of the illicit cigarette market in 2010 was 40.7%, the excise revenues from tobacco products decreased by 20.1%.	The share of the illicit market has decreased by more than half to 18.7%. The budget revenues have increased by more than 30%.
Hungary	2010-2012	5,5	The share of the illicit cigarette market in 2009 was 6.6%. In 2010 the excise revenues from tobacco products decreased by 25.4%.	The share of the illicit cigarette market has been reduced by 2.5 percentage points. Since 2011 the positive dynamics of the excise revenues from tobacco products have been restored.
	2014-2015	0	The rapid growth of the illicit cigarette market share to 8.8% due to the excise shock in 2013. The excise revenues from tobacco products decreased by 7.8% in 2013, and by another 16.7% in 2014.	The share of the illicit market has decreased by more than half to 4.3%. In 2015 the budget tax revenues have increased.

Source: prepared by the authors on the basis of *Taxation and Customs Union*, *Euromonitor* data

In ***Bulgaria*** the minimum excise duty on cigarettes increased from 35.08 to 75.67 euros per thousand units or 2.2 times in 2008-2010. As a result, already in 2010, the share of the country's illicit tobacco market exceeded 30%, there was a decrease in the budget revenues. The government's reaction to these processes was to freeze the excise duty for five years, despite inflation. The rate increased only in 2016 by 8.8%, and further regulation of the tax burden on cigarettes was taking into consideration the dynamics of population incomes and the tobacco product affordability index. The measures mentioned ensured the gradual decrease in the share of the illicit cigarette trade and the excise revenues increase.

In ***Latvia*** MED on cigarettes increased 3.2 times to 67.73 euros per thousand units in 2008-2009, which was immediately reflected in a significant drop in sales volumes of legal products and the budget revenues. The excise duty revenues from tobacco products decreased by more than 20% for two consecutive years, and the share of the illicit cigarette market reached 37% in 2010. Such effects of the reform caused the suspension of the excise duty increase on cigarettes in 2010-2011 and the gradual increase in its rates in 2012-2013. Since 2011 began the gradual decrease in the illicit tobacco market share and increase of the excise duty revenues from this category of products.

In three years in ***Lithuania*** because of the excise shock (in 2010 MED on cigarettes tripled to 64 euros per thousand units), the illicit market of tobacco products has grown to the mark of 40%, and the excise revenues from these products decreased by 20.1%. The government of the country was forced to adapt to this. For the next two years, the excise duty rate on cigarettes was not revised, and in 2013 and 2014 it increased by about 5% per year. The result of this decision was the gradual decrease in the indicators of the illicit cigarette trade and the increase in the fiscal efficiency of the excise duty.

In ***Hungary*** MED on cigarettes increased by 31.9% to 62.8 euros per thousand units in 2008-2009, which caused the growth of the illicit tobacco market. Excise duty revenues from tobacco products decreased by 25.4% in 2010. The government's reaction to such situation was slowing down the growth of the excise duty. In 2010-2012, the minimum excise duty on cigarettes increased only by 5.5%. However, later the country chose to go down the same road, having raised the rate in 2013 by 32%. The consequence of this reckless step was decrease in the excise duty revenues from tobacco products for two consecutive years in 2013 and 2014 and the sharp increase in the level of illicit cigarette trade to 8.8%. Therefore, the government froze the tax rate again in 2014-2015, which allowed the growth of the budget revenues since 2015 and reduce the illicit share to 4.3%.

The above-mentioned confirms the critical need to provide a number of EU countries with transitional period to implement the "90 euros" rule.

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2.2. Excise duty increase schedules in Ukraine

Like described in Subsection 2.1 cases of increase of the illicit cigarette trade level with increasing the excise duty rates were observed in Ukraine. Even in conditions where the government acted with prejudice, introducing schedules for changing tax rates. At the same time, the main driving force behind the increase in the excise burden on cigarettes in the last decade were precisely the European integration tasks and priorities.

Even at the stage of the ratification of the Association Agreement with the EU Ukraine has undertaken commitments ***gradually*** *align excise duty rates on tobacco products with their minimum levels in the EU, taking into account limitations of the regional context and harmonization of policies on combating fraud and smuggling of excisable goods.* This had a decisive impact on further legislative changes in the relevant area.

By the Law of Ukraine from 7 December 2017 No. 2245-VIII "On amendments to the Tax Code of Ukraine and certain legislative acts of Ukraine to ensure balanced budget revenues in 2018" was introduced a seven-year plan to increase the excise duty on tobacco products (in accordance with the Council Directive 2011/64/EU requirements). This law regulated the ***annual increase*** in the specific excise duty rates on all tobacco products and the ***minimum excise duty liability (minimum excise duty) on cigarettes by 20%*** until 2025, so that Ukraine could meet the EU cigarette excise standard of 90 euros per units. The exception was 2018, when the rates increased by 30%. Namely, it was provided to increase the minimum excise duty on cigarettes in 2018-2025 ***from 773.2 to 3019.85 hryvnias per thousand units***, which, considering the exchange rate at that time, corresponded to the level of 90 euros.

The above-mentioned increase in the excise duty rates had a tangible impact on the cigarette market volume. A typical situation during the preparation and adoption of the state budget was the overestimation of the excise duty revenue plan for tobacco products[4]. Since 2018 the growth of the shadow cigarette market started to 4.5%, which was measured in billions of losses of the budget revenues[5]. In 2019 the excise duty revenue plan for tobacco products produced in Ukraine was under-executed by 24%. The Ministry of Finance had forecasted an increase in cigarettes sales, but the market has gone down by 20%[6]. According to the Law of Ukraine from 23 November 2018 No. 2628-VIII "On amendments to the Tax Code of Ukraine and

[4] Conclusions of the Accounting Chamber of Ukraine on the results of the analysis of the annual report on the implementation of the Law of Ukraine "On the state budget of Ukraine for 2018". URL: https://rp.gov.ua/upload-files/Activity/Collegium/2019/8-5_2019/Vysn_vyk_dbu_2018_8-5_2019.pdf
[5] Conclusions of the Accounting Chamber of Ukraine on the results of the analysis of the annual report on the implementation of the Law of Ukraine "On the state budget of Ukraine for 2019". URL: https://rp.gov.ua/upload-files/Activity/Collegium/2020/9-1_2020/Vysn_9-1_2020.pdf
[6] The same

certain other legislative acts of Ukraine regarding improvement of administration and revision of rates of certain taxes and fees" the excise duty rates on tobacco products were additionally increased by 9% from July 1, 2019.

In 2020, compared to 2019 cigarette production volume decreased by 0.8%[7], and its illicit segment increased by 0.3 percentage points to 6.9% of the total market capacity. In 2021 cigarette production decreased by 9.4% and the share of its shadow market increased to 16.9% (by 10 percentage points).

2022 (the beginning of the full-scale invasion) was a shock for Ukrainian society and the national economy. The legal cigarette market declined by about 25%, and the volume of its production in Ukraine, according to the Ministry of Finance, has decreased by 40%. On the other hand, the illicit tobacco market continued to grow, which was reflected in the increase in tax revenue losses at the level of over 20 billion hryvnias.

Upon planning excise duty revenues on tobacco products, changes in the market structure were not taken into consideration. In 2023 compared to 2022 sales of Ukrainian-made cigarettes increased by 29.4%; however, when forecasting the excise duty revenues, no increase in sales of these products was expected[8]. At the same time, the excise duty plan on imported tobacco products was under-executed by 21.3%. The main reason for this was not changes in cigarette sales, but a significantly lower volume of imports of electrically heated tobacco products (hereinafter referred to as HTPs) (6.1 billion units) compared to the planned indicator (7.0 billion units).

In 2024, there was a decrease in domestic cigarette production by 11% and a decrease in its import by 20%. At the same time, there were positive movements regarding combat against illicit tobacco market, which made it possible to achieve tax revenues increase. Coordinated actions by the authorities, control bodies, and law enforcement agencies ensured a decrease in the level of the illicit cigarette trade to 16.1%. If systemic countermeasures were not realized, a shadow tobacco market would have expanded, and budget losses would have increased. The issue of law enforcement during the increase in excise duty is one of the key ones.

In 2025 there was a decrease in cigarette production in Ukraine to 29.1 billion units (by 2.6 billion units), an increase in its import to 4.3 billion units (by 1 billion units) and an increase in exports to 7.0 billion units (by 1.3 billion hryvnias). The share of the illicit tobacco market was 15.9%.

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[7] Conclusions of the Accounting Chamber of Ukraine on the results of the analysis of the annual report on the implementation of the Law of Ukraine "On the state budget of Ukraine for 2020". URL: https://rp.gov.ua/upload-files/Activity/Collegium/2021/7-1_2021/Vysn_7-1_2021.pdf

[8] Conclusions of the Accounting Chamber of Ukraine on the results of the analysis of the annual report on the implementation of the Law of Ukraine "On the state budget of Ukraine for 2023". URL: https://rp.gov.ua/upload-files/Activity/Collegium/2024/22-1_2024/Vysn_22-1_2024.pdf

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Figure 2.1 demonstrated that the increase in the minimum excise duty on cigarettes in 2018-2025 was accompanied by a production (consumption) decrease of the legal cigarettes on the domestic market of Ukraine from 65.1 to 26.4 billion units and ***a surge in illicit trade*** of such products. At the same time, in both 2017[9] and 2023[10], about 22-23% of the adult population used cigarettes.

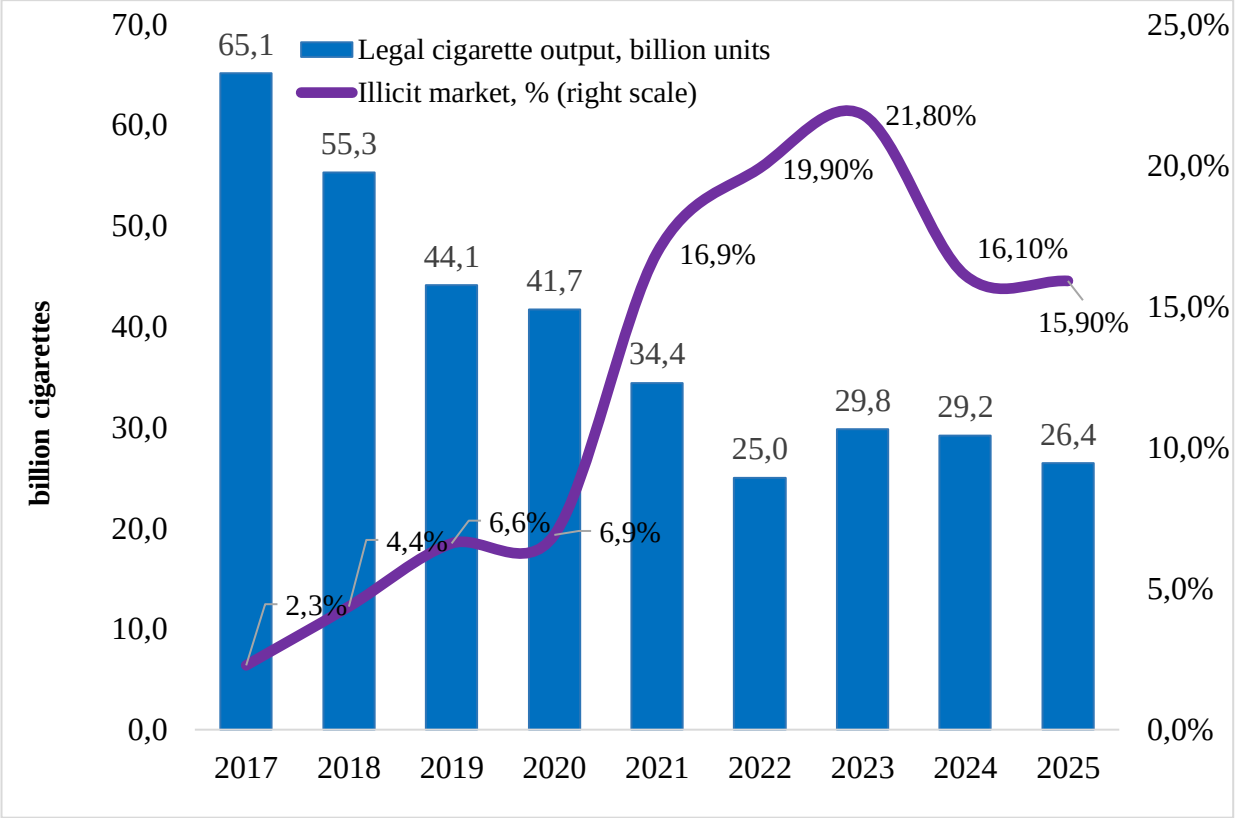


Figure 2.1 Cigarette consumption and illicit market share in Ukraine, 2017-2025

Source: the indicators of the legal cigarette consumption are estimated according to the State Statistics Service of Ukraine and the State Tax Service of Ukraine data, the share of the illicit market is estimated according to *Kantar* data.

Among other factors that had a significant impact on the dynamics of cigarette consumption in Ukraine, it is necessary to mention:

- population decline caused by forced emigration. UN data indicate that, as of November 2025, 5.75 million Ukrainians became refugees due to the full-scale invasion[11];

[9] Data from the Ministry of Health of Ukraine based on the results of the global survey of adults on tobacco use in 2017. URL: https://moz.gov.ua/uk/globalne-opituvannja-doroslih-schodo-vzhivannja-tjutjunu-za-sim-rokiv-poshirenist-kurinnja-v-ukraini-zmenshilas-na-20#!

[10] Use of tobacco and nicotine-containing products: February-March 2025. KIIS. Analytical report. URL: https://center-life.org/wp-content/uploads/2025/05/Zvit-Spozhyvannia-tiutiunovykh-ta-nikotynovykh-vyrobiv-v-Ukrai-ni-2025.pdf

[11] UN. Ukraine Refugee Situation. URL: https://data.unhcr.org/en/situations/ukraine

- transition of some consumers to alternative products (electronic cigarettes, HTPs, cigarillos, rolling cigarettes, nicotine pads).

In 2025 had not yet been fully implemented *the plan for the excise duty increase on tobacco products for 2018-2025 was replaced by a new schedule*.

The Law of Ukraine from 4 December 2024 No. 4115-IX "On amendments to the Tax Code of Ukraine and other laws of Ukraine regarding revision of the excise duty rates on tobacco products" introduced the excise duty rates on tobacco products in euros in order to minimize the impact of hryvnia devaluation regarding fulfillment of the state's obligations to comply with the "90 euro" rule for cigarettes. The adopted amendments to the legislation were aligned with the provisions of the National Revenue Strategy until 2030[12] and supported by the IMF, which is an important institution that financially supports Ukraine during a period of full-scale invasion. The Ministry of Finance initially planned that these amendments would come into force from July 1, 2024, but they came into effect from March 25, 2025.

Therefore, there were introduced a four-year schedule for increasing excise duty rates on cigarettes, according to which ***in 2025*** *the minimum excise duty on cigarettes must be* ***78 euros per thousand units, in 2026 – 82 euros, in 2027 – 86 euros, and in 2028 – 90 euros***.

In addition, as in 2024 the excise duty burden on cigarettes at the weighted average price did not reach the level of 60%, a tax norm came into force, which increased the minimum excise duty ***from April 1 to December 31, 2025*** by 10% to ***85.8 euros per thousand units***. Namely, the amount of the excise duty on cigarettes increased by 23% compared to the first quarter of 2025 and by 47% higher than in December 2024. It ***has boosted the risks of the growth of the illicit market of these products and the transition of smokers to consumption of electronic cigarettes, the shadow market share of which is 92.3%***[13]. The competitiveness of the price on liquids for electronic cigarettes in many cases is ensured by the absence of taxes in their price.

The gradual increase of the minimum excise duty on cigarettes in Ukraine in 2026-2028 *is align with the approaches of excise policy formation in Central and Eastern European countries* that have managed the spread of the illicit trade in tobacco products during their accession to the EU (Subsection 2.1). The practice developed by these countries has proven its effectiveness to ensure the stable growth in tax revenues.

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[12] The National Revenue Strategy until 2030. 2023. URL: https://mof.gov.ua/storage/files/National%20Revenue%20Strategy_2030_.pdf

[13] Illicit trade in liquids for electronic cigarettes: UPDATES. Koshchuk T., Pasichnyi M. / edited by Koshchuk T., Growford Institute, Kyiv: 2025. 58 pages. URL: https://www.growford.org.ua/research/nelegalna-torgivlya-ridynamy-dlya-elektronnyh-sygaret-updates/

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3. Approaches to excise taxation of heated tobacco in the EU countries and Ukraine

The Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco (codification) determines principles of harmonization of the structure and rates of the excise duty on cigarettes, cigars, cigarillos and smoking tobacco, but *does not cover taxation of* ***heated tobacco*** *(Heated Tobacco Products, in Ukraine it is electrically heated tobacco products, HTPs)* and other types of novel products, which appeared on the market after its adoption.

It means that **EU countries** can independently define the principles of taxation of heated tobacco. Considering, among other things, that such products, unlike cigarettes, do not burn, but heat to a certain temperature, due to which fewer carcinogenic substances enter the human body. There are studies that confirm this fact[14], but there are no medical conclusions on the long-term consequences of using heated tobacco. It is often called a product with a potentially reduced health risk of consumption, which has an impact on taxation.

The European Commission, having concerns about introducing by countries of the different excise duty systems for heated tobacco, has recommended to tax it at the rate which is applied to the excise category "other smoking tobacco"[15]. It had a decisive influence on the development of the European practice of heated tobacco taxation.

We would like to emphasize that in the Council Directive 2011/64/EU is laid down the principle that the highest excise duty rate should be applied to the most popular tobacco products such as cigarettes. At the same time, if a product appears on the market that does not fall under the existing "narrow sense" definitions, it may be covered by the "broader sense" definition as "other smoking tobacco". Since heated tobacco is consumed only using a special device, it cannot be classified as cigarettes, cigars or cigarillos. Precisely, we can choose the position, together with the European Commission, that heated sticks should be taxed having equated the rate for them to the excise rate on loose tobacco.

As heated tobacco is becoming more widespread, some EU countries have introduced higher excise duties to it compared to other smoking tobacco.

Malgorzata Świejkowska notes that EU countries are free to apply excise duty rates on heated tobacco, which are lower compared to cigarettes. The researcher

[14] FDA permits of IQOS Tobacco Heating System through premarket tobacco product application pathway. 30.04.2019 URL: https://www.fda.gov/news-events/press-announcements/fda-permits-sale-iqos-tobacco-heating-system-through-premarket-tobacco-product-application-pathway

[15] Report from the Commission to the Council on Directive 2011/64/EU on the structure and rates of excise duty applied to manufactured tobacco. 12.01.2018. URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/report_excise_duty_manufactured_tobacco_12012018_en.pdf

concluded that *application of gradual excise duties on heated sticks by European countries is sufficient to generate stable budget revenues; this is fully consistent with other state goals in the socio-economic sphere*[16].

As of October 1, 2025, 10 EU countries (Belgium, Greece, Denmark, Estonia, Ireland, Spain, Cyprus, the Netherlands, the Czech Republic and Sweden) have applied the same excise duty rates on heated tobacco and other smoking tobacco. In Austria, Bulgaria, Latvia, Malta, Romania, Slovakia, Slovenia, Finland and Croatia, the excise duty on heated sticks is defined per unit of tobacco weight, but higher than the excise duty on loose tobacco. In Italy, Lithuania and Hungary, the excise duty on heated tobacco is based on units of product. At the same time, in ***all EU countries, the excise burden on such products is lower compared to cigarettes***.

Taking into account that mixed excise duty rates are applied to cigarettes (specific per thousand units of products and ad valorem as a percentage of the maximum retail selling price), and for heated tobacco, countries have applied either a specific duty rate per unit of tobacco weight in kilograms, or a rate per thousand units of production (Italy, Lithuania and Hungary), or mixed rates (Belgium, Luxembourg, Germany, Poland, Portugal and France), or an ad valorem rate (Spain), the level differentiation of the excise burden on these two types of products is complicated.

Our calculations of the taxation level difference are based on a comparison of the excise duty rate on heated tobacco, converted from a unit of measurement in kilograms to thousand units of products, and the minimum excise duty on cigarettes published by the European Commission. To determine the excise burden on heated tobacco, which is taxed at mixed rates (but without setting a sufficiently high minimum excise duty) or only at an ad valorem rate, should be considered its retail selling price. Therefore, relevant comparisons were not made for Spain and Portugal[17].

Also were not made calculations for Germany due to the complex methodology for calculating excise duty on heated tobacco. The country's heated tobacco tax scheme provides for the following: to the excise duty rate on other smoking tobacco is added a special coefficient, equal to the share of the excise duty on cigarettes minus the excise duty on other smoking tobacco.

The calculation results for other EU countries are described in Table 3.1. In Italy, the comparison is the easiest – the excise duty rate on heated tobacco is 39.5% of the minimum excise duty on cigarettes.

[16] Szwejkowska, M. (2022). Heated Tobacco as a Novelty Tobacco Product Subject to Excise Duty: A Cross-country Comparison. *Teka Komisji Prawniczej PAN Oddział w Lublinie*, *15*(2), 355-364.

[17] It is not correct to use the minimum excise duty rate for these calculations, because heated sticks are quite expensive, and therefore are unlikely to be taxed without application of the ad valorem component, if such a minimum is set at a relatively low level.

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Table 3.1

Level of differentiation of the excise duty on heated tobacco and cigarettes in EU countries* as of October 1, 2025

Countries	**Minimum excise duty on cigarettes,** *euros per thousand units*	**Heated tobacco excise duty,** *euros per thousand units***	**Difference in level rates, %**
Austria	175,0	89,8	48,7
Belgium	353,9	253,9	28,3
Bulgaria	107,1	54,06	49,5
Greece	117,5	41,5	64,7
Denmark	251,6	51,7	79,5
Estonia	186,7	32,9	82,4
Ireland	533,9	99,6	81,3
Italy	209,3	82,7	60,5
Cyprus	121,5	39,8	67,3
Latvia	171,9	73,1	57,5
Lithuania	149,7	89,4	40,3
Luxembourg	144,5	78,7	45,5
Netherlands	390,4	91,9	75,5
Malta	165,0	37,1	77,5
Poland	157,7	36,0	77,2
Romania	140,7	62,3	55,6
Slovakia	148,0	56,0	63,0
Slovenia	150,0	49,3	67,1
Hungary	117,5	98,8	15,9
Finland	389,6	79,5	80,5
France	378,8	303,8	19,8
Croatia	124,2	52,6	57,6
The Czech Republic	173,0	43,1	75,1
Sweden	187,6	60,4	67,8
On average in the EU	**-**	**-**	**52,0**

* In the context of countries where heated tobacco is taxed only at a specific excise duty rate, as well as in Belgium, Luxembourg, Poland and France, where are set entirely high minimum excise duties for such products when applying a mixed taxation system.

** The calculations were made considering the fact that the tobacco weight in a pack of 20 sticks is 5.3 g.

Source: European Commission. Taxes in Europe Database. URL: https://trade.ec.europa.eu/access-to-markets/en/content/excise-duties#toc_3

Thus, *among 24 analyzed countries, the ratio of excise duties on heated tobacco and cigarettes ranged from 82.4% in Estonia to 15.9% in Hungary, while the EU average for this indicator was* ***52.0%****.*

Malta was the latest EU country who has introduced the excise duty on heated tobacco. It happened in the second half of 2025 after lifting the ban on such products. In 2025, most EU countries included in Table 3.1 (except Greece, Denmark, Cyprus

and Slovakia) increased the excise duty rate on heated tobacco. As a rule, such an increase was accompanied by an increase in the excise burden on cigarettes.

On July 16, 2025, the European Commission published a proposal to update the Council Directive 2011/64/EU, where the approach to the taxation of heated tobacco at the EU level was justified. This initiative considers both the current practice of taxation of such products in EU countries and the fact that heated tobacco may be distributed on the market not only in sticks but also in capsules. This is discussed in more detail in Subsection 4.1.

In **Ukraine**, in 2016-2020 heated tobacco was taxed as an excise category "tobacco substitutes". According to the calculations of the Ministry of Finance, taking into account the weight of tobacco mixture in heated sticks, in 2018 the excise duty rate on HTPs calculated per unit of product was 217.85 hryvnias per thousand units; in 2019, it increased by 20% to 261.41 hryvnias per thousand units, from July 1, 2019 – by additional 9% to 284.94 hryvnias per thousand units; in 2020, this rate increased by 20% to 341.93 hryvnias per thousand units[18].

The authorities paid attention to the fact that HTPs share in the structure of tobacco consumption has significantly grown, seeing this as an impact of lower excise duty rates compared to cigarettes. In 2018, about 1 billion units of such products were imported; in 2019, this indicator increased 3.4 times to 3.3 billion units, in 2020 – 1.5 times to 5.0 billion units.

In 2019, the Head of the Parliamentary committee on finance, tax and customs policy *Danylo Getmantsev* initiated changes regarding approach of HTPs excise taxation, which was enshrined in the Law of Ukraine from 16 January 2020 No. 466-IX "On amendments to the Tax Code of Ukraine regarding improvement of tax administration, elimination of technical and logical inconsistencies with tax legislation". In particular, by the law HTPs were allocated to a separate group of excisable products. In addition, temporary rates for tobacco products, tobacco and industrial tobacco substitutes were established for the period from January 1, 2021 to December 31, 2024. *The excise duty rate on heated tobacco increased immediately by 4.2 times to 1,456.33 hryvnias per thousand units, to the level of the minimum excise duty liability (minimum excise duty) on cigarettes*. It was assumed that HTPs rate would increase annually similarly to the excise duty rates on cigarettes. Unlike EU practices, which involve applying a differentiated approach to taxation of various tobacco products, the path of excise burden equalizing was chosen.

In 2021 the imports volume of HTPs reached a historical maximum of 7 billion units, but in 2022, imports of heated tobacco collapsed by more than half. In 2023 it recovered to 6.8 billion units, showing a slight downward trend, and in 2024

[18] Ministry of finance of Ukraine. Consolidated budget revenues for 2021. URL: https://mof.gov.ua/storage/files/Zvit_2021_%D1%81%D0%B0%D0%B9%D1%82.pdf

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it decreased to 6.3 billion units. The production of such products in Ukraine began in 2022 and presents for about 10-15% of the volume of this market.

The unification of the excise duty rates on cigarettes and heated tobacco did not last long. In the Law of Ukraine from 4 December 2024 No. 4115-IX "On amendments to the Tax Code of Ukraine and other laws of Ukraine regarding revision of the excise duty rates on tobacco products" was taken into account established and effective practice in the EU of differentiation of the tax rates of these types of products, which allows to prevent the expansion of illicit markets of tobacco and nicotine-containing products and budget losses as a result.

We would like to emphasize that this law came into force not on January 1, 2024, but on March 25, 2025 due to a delay in the President's signature. Therefore, at the beginning of 2025, the excise duty rates on heated tobacco and cigarettes were applied, provided by the previous excise plan, and due to the difference in rates not considered in the approved budget, the government lost about 2 billion hryvnias[19] for almost three months of delay. This concerns the unearned revenues from the excise tax, VAT and the retail excise tax.

Thus, on March 25, 2025, the minimum excise duty on cigarettes increased to 78 euros per thousand units, and the excise duty rate on HTPs increased to 70.4 euros; the differentiation of the excise duty burden on these types of products was less than 10%.

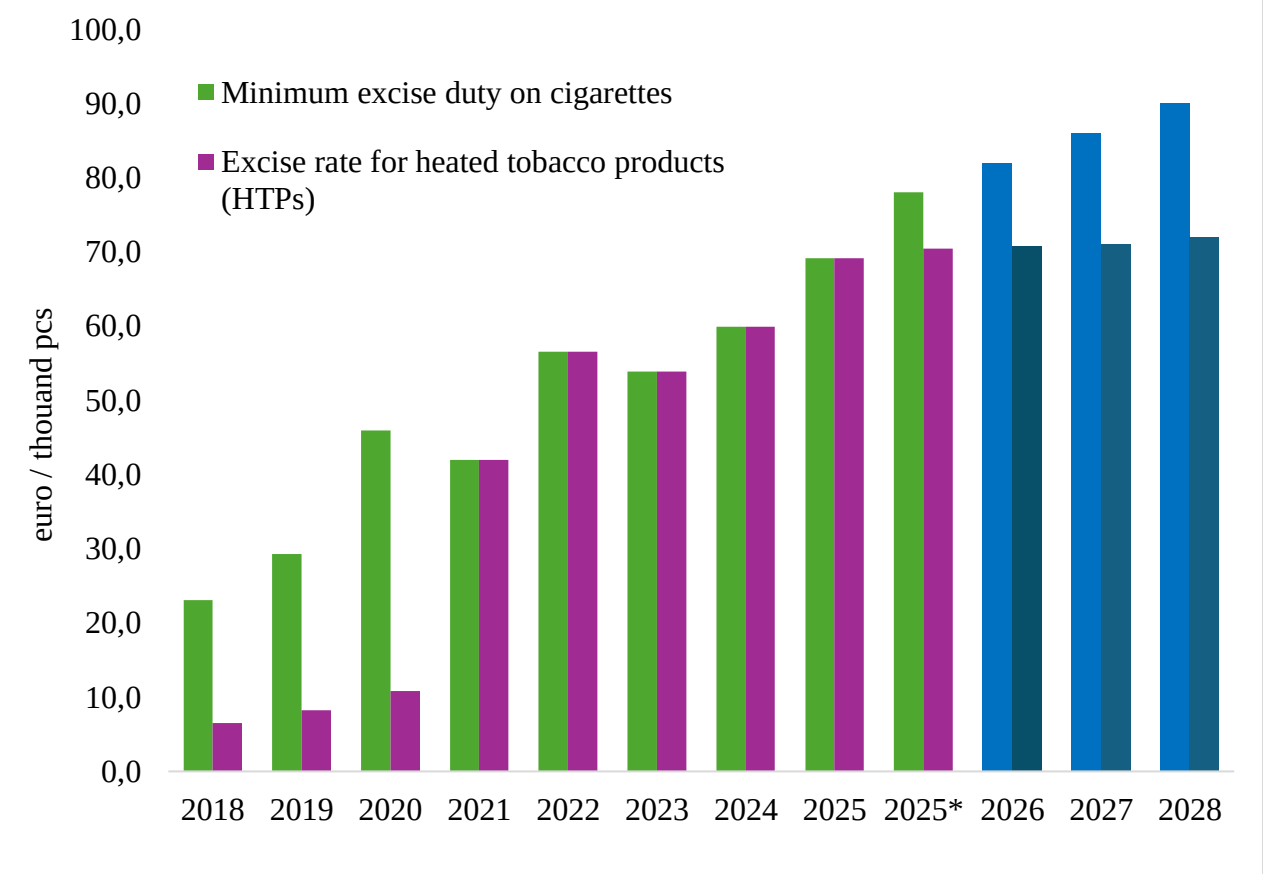
In addition, as in 2024 the share of the excise duty on cigarettes at the weighted average price did not reach the level of 60%, a tax norm came into force, which increased the minimum excise duty on such products from April 1 to December 31, 2025 by 10% to 85.8 euros per thousand units.

It is also planned to increase excise duty rates for 2026-2028. The minimum excise duty on cigarettes will increase at a rate of about 5% per year in euros (except for 2026, if the requirement regarding the share of the excise duty in the weighted average selling price of cigarettes of at least 60% is met), having reached 90 euros per thousand units at the final stage of the reform. The excise duty rate on HTPs should increase to 72 euros in 3 years. From January 1, 2026 the minimum excise duty on cigarettes is 82 euros per thousand units, and the tax rate on heated tobacco is 70.8 euros per thousand units. Such changes are in line with the provisions of the Council Directive 2011/64/EU and the practice of EU countries. ***From 2028, the differentiation of excise duty rates on these types of products in Ukraine will be only 20%, while the minimum excise duty burden on heated tobacco for EU countries will be half as low as that on cigarettes (Subsection 4.1)***.

Figure 3.1 presents the minimum excise duty on cigarettes and excise rates on HTPs, expressed in euros, for the entire analyzed period. When calculating for 2018-

[19] Yaroslav Zheleznyak's official *Telegram* channel. URL: https://t.me/yzheleznyak/12040

2024, the official euro exchange rate set by the NBU at the beginning of the corresponding year was considered. *Taking into account the trend of significant devaluation of the hryvnia, the actual rate of future rate increases will be higher.*



* from April 1, 2025 due to the entry into force of the provisions of the Law of Ukraine from December 4, 2024 No. 4115-IX

** rates for 2026-2028, defined in the Tax Code of Ukraine

Figure 3.1 Excise duty rates on cigarettes and HTPs in Ukraine in 2018-2028

Source: prepared by the authors according to data from the State Tax Service of Ukraine and the NBU

The tobacco tax policy should be balanced. It should be reflected in increasing budget revenues and limiting the prevalence of smoking, rather than in reorienting consumers to illicit products. The main alternatives to cigarettes today are heated tobacco and electronic cigarettes. According to the survey results made by *the Kyiv International Institute of Sociology*, the consumption of these alternatives in Ukraine is almost identical[20]. *The World Health Organization* provides slightly different estimates: as of 2024, ***17.8%*** of adult Ukrainians used cigarettes, ***5.3%*** used electronic cigarettes, and ***2.6%*** used HTPs[21].

[20] Use of tobacco and nicotine-containing products: February-March 2025. KIIS. Analytical report. URL: https://center-life.org/wp-content/uploads/2025/05/Zvit-Spozhyvannia-tiutiunovykh-ta-nikotynovykh-vyrobiv-v-Ukrai-ni-2025.pdf

[21] Use of tobacco and nicotine products among adults in Ukraine - results of a sociological survey of adults aged 18 and over - Comparative analysis of survey results from 2023 and 2024. WHO. Use of tobacco and nicotine products

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HTPs market in Ukraine is developing totally in legal segment, which confirms the growth of excise duty amount paid on such products, which in 2025 amounted to 18.5 billion hryvnias. In return, the market of liquids for electronic cigarettes is more than 90% illicit; e-liquids excise revenues amounted to about 0.5 billion hryvnias[22].

European integration processes necessitate the approximation of Ukraine's excise policy to EU standards and practices, an element of which is the differentiation of the excise burden on heated tobacco and cigarettes. In addition, *during the war, it is especially important that smokers transition from cigarettes to HTPs ensures legal products consumption and the payment of all taxes to the budget stipulated by law.*

among adults in Ukraine - results of a sociological survey of adults aged 18 and over - Comparative analysis of survey results from 2023 and 2024. WHO. URL: https://www.who.int/ukraine/uk/publications/m/item/tobacco-and-nicotine-product-use-among-adults-in-ukraine---findings-from-a-sociological-survey-among-adults-aged-18-years-and-over---comparative-analysis-of-the-2023-and-2024-survey-rounds

[22] Illicit trade in liquids for electronic cigarettes: UPDATES. Koshchuk T., Pasichnyi M. / edited by Koshchuk T., Growford Institute, Kyiv: 2025. 58 pages. URL: https://www.growford.org.ua/research/nelegalna-torgivlya-ridynamy-dlya-elektronnyh-sygaret-updates/

4. European Commission proposal to revise the Council Directive 2011/64/EU

In 2020, the European Commission published evaluation results on the Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco (codification)[23], having concluded that the relevant EU rules needed to be revised. Since then, work on updating them has begun, which has been accompanied by discussions.

4.1. Changes provided by the updated version of European harmonized standards

After public discussion of issues and extensive consultations with a wide range of stakeholders, on July 16, 2025, the European Commission published a compromise ***Proposal to the Council Directive on the structure and rates of excise duty applied to manufactured tobacco (codification)*** [24] (hereinafter referred to as the Proposal). The document introduces changes of the current excise duty rules in the EU, that should come into force in January 1, 2028, and some of them – in 2029-2032[25]. There are several reasons for modernizing the Council Directive 2011/64/EU.

Firstly*, there is the need to increase the minimum excise duty rates*, which have not been reviewed for over a decade and require a unified approach to achieve the objectives of the tax and health policy. For example, the minimum excise duty on cigarettes is set at the level of 90 euros per thousand units and it is stipulated that the sum of ad valorem and specific excise duties must be at least 60% of the weighted average retail selling price of the product. If the minimum excise duty is at least 115 euros per thousand units, then the "60% rule" can be disregarded. These standards are outdated (see Section 1).

Secondly*, novel products have emerged and gained popularity*. The tobacco market has changed structurally since 2011, when the Council Directive 2011/64/EU was adopted. The rapid spread of alternatives to cigarettes and other traditional tobacco products has affected consumer behavior and preferences. Namely, it is about the following products:

1. Liquids for electronic cigarettes *(liquids for e-cigarettes/vapes, e-liquids)*. On average, **e-cigarette prevalence of use among the adult population in the EU**

[23] Commission staff working document Evaluation of the Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco. February 2020. URL: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52020SC0032

[24] Proposal for a COUNCIL DIRECTIVE on the structure and rates of excise duty applied to tobacco and tobacco related products (recast). 16.7.2025. COM(2025) 580. URL: https://taxation-customs.ec.europa.eu/document/download/420ebf11-933d-46c0-8915-5a306c6bcb47_en?filename=COM_2025_580_1_EN_ACT_part1_v7.pdf

[25] Revision of the Tobacco Taxation Directive (proposal) URL: https://taxation-customs.ec.europa.eu/taxation/excise-taxes/excise-duties-tobacco/revision-tobacco-taxation-directive-proposal_en

is 6.5%. In some member states, this figure has already exceeded 10%[26]. The popularity of electronic cigarettes is growing rapidly.

2. Heated tobacco *(electrically heated tobacco products, HTPs)*. Some studies show that HTPs use is almost as widespread as vaping[27]. However, the European Commission has data showing that they are less popular than e-cigarettes[28].

3. Other manufactured tobacco (chewing tobacco/snuff);

4. Nicotine pouches *(pads)*, etc.

Currently, mentioned products are not covered by the Council Directive 2011/64/EU, which leads to different interpretations of their categorization for taxation purposes and coverage by *the Excise Movement and Control System (EMCS)* across the territory of the EU member states. For example, countries apply the excise duty on heated tobacco but use different tax bases (weight or number of units) or apply different rates depending on the physical characteristics of the product (sticks/non-sticks).

In view of this, the European Commission proposes to extend the scope of the Council Directive 2011/64/EU to new types of products and provide harmonized definitions for heated tobacco (updated Article 7), other manufactured tobacco (Article 8), liquids used in electronic cigarettes (Article 9), nicotine pouches and other nicotine products (Article 10).

Thirdly*, the problems associated with the illicit tobacco market are becoming more acute.* To improve the combat against illicit trade in tobacco products, *it is proposed to include raw tobacco in the scope of updated directive* (new provisions, Articles 2 and 23).

The Proposal pays considerable attention to ***reviewing both the rate of the minimum excise duty rates*** (Table 4.1) ***and the approach to their setting***. In particular, *the minimum excise rate on* ***cigarettes*** *should increase to 215 euros per thousand units and* ***will be adjusted for the price level index***. This means that ***the single minimum rate in the EU will be replaced by its national analogues***, while defining which will be considered the economic situation in the country by adjusting the base rate on *the Price Level Index (PLI)* of the country. *PLI* is calculated by Eurostat. 2/3 of the tax rate will be fixed, and 1/3 will be adjusted based on the purchasing power parity of European countries. A description of the scope of the latest indicator application is given in Subsection 4.2.

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[26] Attitudes of Europeans towards tobacco and related products. Report. European Commission. 2024. URL: https://europa.eu/eurobarometer/surveys/detail/2995

[27] Laverty, A. A., Vardavas, C. I., & Filippidis, F. T. (2021). Prevalence and reasons for use of Heated Tobacco Products (HTP) in Europe: an analysis of Eurobarometer data in 28 countries. *The Lancet Regional Health–Europe*, *8*.

[28] European Council Health risks of second-hand smoke and aerosols https://www.consilium.europa.eu/en/policies/smoke-free-environments/#0

Table 4.1

New minimum excise duty rates proposed for tobacco and nicotine-containing products in the EU

Tobacco/nicotine-containing product	Minimum rate 2028-2029	Minimum rate 2030-2031	Minimum rate from 2032	Rates review
Cigarettes	63% of the weighted average retail price, but not less than 215 euros per 1000 units			The minimum rates, expressed either per kg, per ml or per certain number of units, are adjusted every three years in accordance with Article 12 of the recommendations to the revision of the directive to reflect average inflation trends in the EU and differences in price levels between member states.
Cigars	5% of the retail price or 12 euros per 1000 units	20% of the retail price or 71.5 euros per 1000 units or per kg	40% of the retail price or 143 euros per 1000 units or per kg	
Cigarillos	5% of the retail price or 12 euros per 1000 units	20% of the retail price or 71.5 euros per 1000 units or per kg	40% of the retail price or 143 euros per 1000 units or per kg	
Fine-cut tobacco for rolling cigarettes	62% of the weighted average retail price or 215 euros per kg			
Other smoking tobacco	20% of the retail price or 22 euros per kg	25% of the retail price or 71,5 euros per kg	50% of the retail price or 143 euros per kg	
Hookah tobacco	20% of the retail price or 22 euros per kg	25% of the retail price or 54 euros per kg	50% of the retail price or 107 euros per kg	
Heated tobacco (electrically heated tobacco products, HTPs)	45% of the retail price or 88 euros per 1000 units or 125 euros per kg	50% of the retail price or 98 euros per 1000 units or 140 euros per kg	55% of the retail price or 108 euros per 1000 units or 155 euros per kg	
Other manufactured tobacco	0% of the retail price or 0 euros per kg	25% of the retail price or 71,5 euros per kg	50% of the retail price or 143 euros per kg	
Liquids for electronic cigarettes	for liquids containing <15 mg nicotine per ml: 20% of the retail price or 0.12 euros per ml; for liquids containing >15 mg nicotine per ml: 40% of the retail price or 0.36 euros per ml			
Nicotine pouches	There is no EU minimum rate	25% of the retail price or 71,5 euros per kg	50% of the retail price or 143 euros per kg	
Other nicotine products	There is no EU minimum rate	25% of the retail price	50% of the retail price	

Source: based on the Revision of the Tobacco Taxation Directive (proposal) URL: https://taxation-customs.ec.europa.eu/taxation/excise-taxes/excise-duties-tobacco/revision-tobacco-taxation-directive-proposal_en

The minimum rates for all types of products should be adjusted every three years (in accordance with Article 12 of the Proposal) to reflect inflation trends in the EU and differences in price levels between member states.

Using the example of cigarettes, we will demonstrate that the minimum rate can be both lower and higher than 215 euros per thousand units depending on the adjustment indicator. *Therefore, in the countries of Central and Eastern Europe, the excise duty will be lower, taking into account economic realities.* Considering *PLI* for 2024[29], for ***Bulgaria*** the adjustment indicator of the minimum excise duty on cigarettes will be ***186.1 euros*** per thousand units, which is 18.4% lower than the base indicator. In return, in ***Denmark***, one of the most economically developed countries in the EU, this excise duty will be ***245.9 euros*** per thousand units.

In addition, the requirement for the excise duty share in the weighted average retail price of cigarettes is being modified – it should be already 63%. In order not to comply with this standard, the minimum excise duty in the country should be at least *274 euros (adjusted for the price level index)*.

The "90 euros" rule for cigarettes at the EU level has not been changed for over a decade, but countries have independently increased the level of the excise duty to achieve public policy goals. In 2025, the lowest minimum excise duty on cigarettes in the EU was in Bulgaria – 107.1 euros per thousand units. In Greece, relevant tax was 117.5 euros, Poland – 157.7 euros, Estonia – 186.7 euros, Germany – 241.6 euros, France – 378.8 euros.

Therefore, despite significant increase in the European minimum excise duty on cigarettes, for some EU countries it will not be a significant challenge in the tax regulation field. ***The greatest risks will arise for the eastern flank of the EU, where surges in illicit cigarette trade have already been observed with a significant increase in the tax burden.*** For ***Bulgaria***, the excise duty should be increased by 74.2 euros (or 2/3) over 2 years, which is considered as the tax shock. The new "215 euros" rule will also create serious threats to ***Greece***, which suffers from illicit tobacco, and some other EU-15 countries (more in Subsection 4.3). It is extremely important to strengthen simultaneously the effectiveness of combating the illicit tobacco market.

A transitional period is provided until January 1, 2032 to increase the minimum excise duties for a number of other products. It concerns cigars, cigarillos, heated tobacco and hookah tobacco, other processed tobacco, nicotine pouches, and other nicotine-containing products. The rates for them *will be increased gradually in three stages: the first – 2028-2029; the second – 2030-2031; the third – from 2032. The transitional period will not apply only to cigarettes, fine-cut tobacco for rolling cigarettes as an alternative to them, and liquids used in e-cigarettes*.

The European approach to implementing tobacco and nicotine-containing products taxation policy is based on the principles of predictability and consistency.

[29] Comparative price levels of consumer goods and services - Statistics Explained – Eurostat. URL: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Comparative_price_levels_of_consumer_goods_and_service

Arthur Laffer recommends taking these principles into consideration when forming tax policy to avoid tax shocks and sharp surges in the shadow economy indicators. A sharp increase in the tax burden leads to market imbalances and a loss of overall economic efficiency (Section 2, Subsection 4.3).

It is important to focus ***on the rate and differentiation of excise duty rates in terms of excise duty categories.*** The EU institutions propose to set in European legislation the differentiation of taxation of cigarettes and their alternatives (heated tobacco, e-liquids and nicotine pouches). The European Commission's position is that when defining the minimum excise duty rate, for example, for **heated tobacco**, consumption habits, current prices and current tax rates in EU countries should be considered (Table 3.1, Section 3). Harmonization of the approach to taxation and implementation of the minimum rate at the EU level will improve the effectiveness of the government control and provide countries with flexibility in adapting taxation rules to changes in HTPs[30] market.

The common approach to heated tobacco taxation in EU countries is evidence of the tax policy modernization. Most stakeholders during public consultations expressed support for harmonization of legislation on excise taxation of such products.

It is stipulated that from January 1, 2032 *the minimum excise duty rate on heated tobacco will be 55% of the retail price or 108 euros per thousand units*. Countries where the tax base for such products is set per unit of weight will be able to set a rate of at least *155 euros per kg*. The rates will be adjusted on *PLI*. ***The minimum excise burden on HTPs in the EU will be half of cigarettes.***

During transitional period from January 1, 2028 to December 31, 2029 the minimum duty rate on heated tobacco will be 88 euros per thousand units, and from January 1, 2030 to December 31, 2031 it will be – 98 euros. *A smooth transition to higher rates is proposed by the European Commission to avoid abrupt structural changes in the tobacco market.*

The tax increase will also affect other traditional tobacco products, in particular **cigars and cigarillos**. The excise duty rate for them will increase from 12 euros per thousand units in 2028 to *143 euros per thousand units (or per kg)* in 2032. The excise burden on cigars and cigarillos should increase 12 times over 4 years. The minimum excise duty rate on **hookah tobacco** in 2028-2032 will increase from 22 to *107 euros per kg*. **Nicotine pouches** *will be taxed at the same excise rate* as other smoking tobacco and other processed tobacco only from 2030; for these categories, the excise duty will increase as follows: from 2028 the minimum rate will be set at 20% of the retail price or 22 euros per kg; in 2030-2031 – 25% of the retail price or

[30] European Commission. Tobacco Taxation: Frequently asked questions. URL: https://taxation-customs.ec.europa.eu/document/download/3e526c91-e7a1-400b-a64b-19ba0361ae46_en

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71.5 euros per kg; from 2032 – *50% of the retail price or 143 euros per kg*. The base rates will be adjusted on the price level index of the countries starting ***from 2032***.

The excise duty rates on **liquids for electronic cigarettes** should be expressed as a percentage or as a fixed amount per 1 ml: *for liquids with a nicotine content from 0 to no more than 15 mg per ml* – 20% of the retail price or *0.12 euros per ml*; *for liquids with a nicotine content of more than 15 mg per ml* – 40% of the retail price or *0.36 euros per ml* (adjusted on *PLI*).

The fact that deserves special attention is that *nicotine-free e-liquids are covered by the scope of the updated directive* to minimize tax evasion schemes through "self-blending" (when nicotine is added to nicotine-free liquids by vapers themselves). At the same time, *the differentiation of excise duty rates for e-liquids depending on nicotine concentration*, which was initiated by the European Commission to consider the diversity of products, *may complicate tax administration and provoke abuse*.

Most EU countries, not waiting for the European Commission's decisions, have already introduced taxation of e-cigarette liquids, mostly at a flat rate, and some member states have applied certain bans on vaping products[31]. The more countries introduced measures to regulate e-cigarettes and liquids to them, the more EU institutions were inclined to set harmonized approaches to regulation and taxation of such products.

Nicotine pouches and other nicotine-containing products are becoming increasingly popular. Approaches to their state regulation in EU countries vary significantly: from no regulation at all to strict bans[32]. Common taxation rules will contribute to the development of institutional frameworks for functioning of this market.

The scenario presented in the Proposal ***brings the excise duty rates on novel products closer to other smoking tobacco rates***, *which are the lowest among all rates*. The European Commission believes that introduction of European standards to taxation of these products should ensure the generation of the additional budget revenues of 900-1.7 billion euros.

The rules for novel products taxation will facilitate trade in the EU and create a level playing field for economic operators in the internal market, and the prevalence of unified EU-wide control over the turnover of such products will ensure efficient and effective excise administration, contributing to revenues generation that are currently not being collected.

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[31] Illicit trade in liquids for electronic cigarettes: UPDATES. Koshchuk T., Pasichny M. / edited by T. Koshchuk, Growford Institute, K: 2025. 58 pages URL: https://www.growford.org.ua/research/nelegalna-torgivlya-ridynamy-dlya-elektronnyh-sygaret-updates/

[32] Duren, M., Atella, L., Welding, K., & Kennedy, R. D. (2024). Nicotine pouches: a summary of regulatory approaches across 67 countries. *Tobacco control*, *33*(e1)

In the Proposal *special attention is paid on the illicit tobacco market*. Counterfeit and smuggled products (including cigarettes and fine-cut rolling tobacco) are sold at lower price than the legal one, from which taxes are paid. Achieving fiscal goals and reducing smoking prevalence are at risk.

The largest volume of illicit cigarettes in the EU member states is accounted for by "*illicit-white*", a significant share also belongs to counterfeit products. For example, in France (where, as mentioned, the minimum excise duty on cigarettes is high – 378.8 (!) euros per thousand units) is recorded the largest illicit tobacco market in Europe. According to *KPMG* study, in 2024 the volume of illicit cigarettes in this country amounted to 18.7 billion cigarettes, of which 7.8 billion units are counterfeit[33].

Customs and tax authorities have identified one of the reasons for the prevalence of the illicit tobacco market – ***insufficient control over unprocessed tobacco***. In order to limit the access of tobacco raw materials to illicit market players, will be strengthened control over their movement. In particular, in the Proposal it is provided *introduction of a zero-excise duty rate on* **raw tobacco** *and its coverage by the EU Excise Movement Control System (EMCS)*.

The measures proposed by the European Commission are aimed at improvement of tobacco and related products traceability, limitation of opportunities for tax evasion, as well as promoting combat against tobacco products illicit trade. It is expected that additional control measures will help to clear up the tobacco market by 10-20% of the current level of tax losses due to its existence (this is about 13 billion euros each year)[34]. Some EU countries already tax raw tobacco and tobacco waste if they are considered as for smoking. In practice, this significantly complicates reporting on transport or transit of raw tobacco or tobacco waste through the territory of the relevant EU country.

However, the rules initiated in the Proposal are not yet the final version of the updated directive, which will be voted by the EU Council, and may be amended on the results of their public discussion.

4.2. Purchasing power parity and experience of its use in EU countries in other sectors

Purchasing power parity (hereinafter referred to as PPP) in world practice and European countries is used to compare prices of goods and services across different countries, considering exchange rates. In the process of converting costs for goods

[33] Illicit cigarette consumption in Europe. Results for the calendar year 2024. KPMG. URL: https://www.pmi.com/resources/docs/default-source/itp/illicit-cigarette-consumption-in-europe-2024-results.pdf?sfvrsn=4ad3ac8_6
[34] EU Commission presents comprehensive proposal to revise the Tobacco Tax Directive. URL: https://www.cattwyk.com/en-news/eu-commission-presents-comprehensive-proposal-to-revise-the-tobacco-tax-directive

and services into a common currency, their assessment is carried out at a single price level and only differences in volume of purchases in different countries are reflected. In fact, PPP allows to form an idea of quantity of goods and services that can be purchased for a certain equivalent currency in different countries. PPP is actively used for international comparisons of prices and living costs and it is an important indicator of the socio-economic development of society. PPP indicators are used to form a system of price and volume indices necessary for economic research and policies analysis that involves comparing the size of GDP and spendings[35].

In practice, three main indicators of PPP are used:

1. *Indices of real expenditure* – these are measures of volume which reflect the relative magnitudes of the indicators being compared. These indices are used to compare the size of a country's GDP internationally to size its economy.

2. *Indices of real expenditure per capita* – these are measures of volume which reflect the relative levels of the indicators being compared, after adjusting for differences in population density and size across countries. In particular, GDP per capita is used to compare the level of economic well-being of the population.

3. *Price level indices, PLI* – these are the ratios of PPPs to exchange rates. These indices show price levels in a certain country compared to a base period or another country or the average price level in the EU. They can be used to determine how much money (expressed in the common currency) it is possible to spend buying a particular good. They are used to analyze inflation, living costs and economic stability.

As it was mentioned in Subsection 4.1, namely *the price level index* of the relevant EU country the European Commission proposes to take into account when determining the minimum excise duty rates on tobacco and nicotine-containing products in ***the Proposal to the Council Directive on the structure and rates of excise duty applied to manufactured tobacco and related products (new edition***). 2/3 of the tax rates will be fixed, and 1/3 of the rate will be adjusted based on *PLI*, considering the disparities in socio-economic development and purchasing power parity of the EU member states.

In June 2020 the European Council insisted that any future revision of excise duty rates in EU countries should consider the specific economic situations of the countries. The Proposal foresees that the new minimum excise duty rates on tobacco and nicotine-containing products will be adjusted for each country *depending on the purchasing power of its residents*, alongside the EU minimum rates expressed in nominal terms.

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[35] *Eurostat-OECD Methodological Manual on Purchasing Power Parities (2023 Edition)*. Luxembourg: Publications Office of the European Union, 2024. 422 p.

In case of purchasing power increase in an EU country, the minimum excise duty for it will increase, and if this indicator decreases it will be possible to decrease the tax rate. PPP-based approach to setting excise duty rates adjusts for inflationary trends in EU countries, which is consistent with the principles of social justice and economic soundness. One of the main purposes of PPP is to ensure a reliable and representative comparison of price levels in different countries (Table 4.2). *PLI* is calculated by Eurostat for EU member states, some EU accession candidates, Iceland, Norway, Switzerland, the United Kingdom, the United States, Japan, etc.

Table 4.2

Examples of the use of PPP by OECD and Eurostat

PPP	Examples
The main PPP purpose is for:	International comparison of GDP volumes of states and GDP per capita, etc.; Comparison of GDP expenditure components at a certain level of aggregation ("analytical categories"); International comparison of price levels for goods and services.
PPP also can be used for:	Comparison of economic data in national currencies (in fact, PPP is used as an alternative to exchange rates); Analysis of price convergence; Analysis of temporary changes in GDP volumes or price levels;
It is NOT recommended to use PPP for:	Analysis of potential overvaluation or undervaluation of the national currency exchange rate (such as using the Big Mac index); Comparison of living costs for individuals; Comparison of labor productivity, etc.

Source: prepared by authors based on *Eurostat-OECD Methodological Manual on Purchasing Power Parities (2023 Edition)*.

The principle of economic justification is one of the key ones in developing the tax policy in EU countries. Economic disparities and taxpayers' solvency consideration was also indirectly considered by policymakers in formation and implementation of EU excise policy in past periods. In particular, the Central European and Baltic countries were given a transitional period to increase their minimum excise duty on cigarettes. As was shown in Subsection 2.1, in case of increasing the minimum corresponding rate at the EU level from 64 to 90 euros per thousand units, the countries in this sample were given the period 2011-2018 for gradual adaptation to prevent a sharp significant increase in the illicit tobacco product market.

Let us give another example. In accordance with the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax[36], EU

[36] COUNCIL DIRECTIVE 2006/112/EC of 28 November 2006 on the common system of value added tax. URL: https://eur-lex.europa.eu/eli/dir/2006/112/oj/eng

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countries may apply reduced VAT rates. A specific list of goods and services for which this benefit may be applied has been defined, the rate cannot be lower than 5%. The reduced VAT rate is applied by countries on an optional basis. Specific goods and services which are provided for the possibility of its use are food; medicines and medical equipment; publishing books, newspapers, magazines; water supply fees; passenger transport services; fees for visiting cultural heritage sites; services of restaurants, hotels, etc.

The main purpose of applying reduced VAT rates is consideration of the need to maintain the economic agents' solvency, expansion of business activity and consumption.

The directive also identifies certain territories and regions of EU countries where a lower standard VAT rate may be applied, taking into account the economic differences in the development of these territories. This indicates that despite the harmonization of tax rules in the EU, the factor of disparities in economic development is considered to ensure the formation of a balanced and effective tax policy.

The use of PPP ensures a more even distribution of the tax burden, considering national differences in purchasing power. This is relevant for the internal EU market, where countries have different levels of socio-economic development and prices. If the average *PLI* value in the EU is 100, then the lowest level of this index in 2024 was in Bulgaria – 59.7, and the highest in Denmark – 143.1[37]. The deviation of the maximum and minimum values from the average exceeds 40 percentage points. If the country's *PLI* is higher than 100, then the level of prices for goods and services is higher compared to the average for the EU. If the *PLI* value is lower than 100, then the country is relatively "cheap" compared to the EU-27 sample. *Integrating the PPP approach into the tax mechanism will ensure comparative fairness of prices across countries and prevent tax evasion or other tax offenses.*

4.3. Risks of increasing the level of illicit cigarette trade

Changes in excise taxation of tobacco and nicotine-containing products in Ukraine should consider the achievements of scientists and experts, as well as European experience in this area. It is important to study the impact of the tax burden on the level of illicit cigarette trade in countries with developed and transformational economies.

Currently, a wide range of studies have been published, which prove a close connection between the increase in excise duty on cigarettes and the development of their illicit market. Let us show the results of some modern studies.

[37] Price level indices. Eurostat. URL: https://ec.europa.eu/eurostat/databrowser/view/tec00120/default/table?lang=en

Adrian Cooper and Daniel A. Witt have systematized the experience of increasing the excise duty rates on tobacco products in countries with developed and transformational economies. The researchers identified two main approaches to taxation: 1) a sharp increase in excise duty rates (Central and Eastern European countries, Canada, Malaysia); 2) a gradual increase in excise rates (Japan, Italy, and the USA). After conducting an analysis, the researchers concluded that ***the increase of the tax burden on tobacco products without due consideration of the purchasing power of the population leads to an increase in their illicit market and creates risks for budget filling***. In addition, in cases where tax policymakers considered the affordability of tobacco products when regulating the excise duty rates, budget revenues increased, smoking prevalence decreased, and the level of illicit trade was under state control[38].

Juraj Valek states that the sharp increase in excise rates leads to a sharp increase in prices for tobacco products, and high prices are the cause of illicit trade in such products. The shadow market weakens the state's efforts to reduce cigarette consumption using the excise duty instrument. The author attributes the corruption level and insufficient institutional capacity of state fiscal and law enforcement agencies to other reasons for the existence of the illicit tobacco market[39].

James Prieger and Jonathan Kulik studied the cigarette market in the EU, using data from 1999-2013. The researchers identified that as the tax burden on cigarettes increases, ***the price gap between legal and illicit products increases***. This encourages consumers to buy counterfeit and smuggled products. An increase in the price of a cigarette pack by 1 euro led to an increase in the share of their illicit circulation from 5 to 12 percentage points, depending on the EU country. The researchers found that ***the increase in cigarettes price is the main reason for the shadow market volume increase, but not the functional inefficiency of regulatory authorities.*** Therefore, tobacco taxation policy should be balanced and consistent[40].

The research of *the consulting company A&M (Alvarez & Marsal)* is devoted to the issues of defining the causes of the illicit cigarette trade. The analyzed sample covers 32 countries, including the USA, 16 EU countries, Ukraine, etc. The authors provided evidence, using econometric research methods, that the increase in the level of taxation is the main factor of the illicit cigarette market existence. An increase in excise rates reduces cigarettes affordability for consumers, who are forced to look for cheaper products on the market, which in most cases are illicit. Experts

[38] Cooper A., Witt D. The linkage between tax burden and illicit trade of excisable products: the example of tobacco. World Customs Journal. 2012. Vol. 6. Issue 2. P. 41-58.
[39] Valek J. Impact of the European Union membership on illicit trade in selected goods (case of Slovakia). European Journal of Transformation Studies. 2019. Vol. 7. Issue 1. P. 49-66.
[40] Prieger J. E., Kulick J. Cigarette taxes and illicit trade in Europe. Economic Inquiry. 2018. Vol. 56. Issue. 3. P. 1706-1723.

emphasize on the need to increase the validity of tax policy measures and ensure their consistency. The data provided show that ***shortcomings in the tax policy development immediately affect the sharp increase of the volume of the illicit cigarette trade, the consequences of which can be overcome only in the medium and long term***. Measures to combat the illicit trade require proper coordination, significant state financial resources and time spent by regulatory and law enforcement agencies[41].

Arthur Laffer, economic advisor to several US presidents, notes that an *effective tobacco tax policy should meet the following criteria*: 1) increasing excise duty rates should be based on clear economic calculations, taking into account the demand elasticity and the household purchasing power; 2) tax shocks should be avoided; 3) the policy should be balanced, taking into account the interests of the main participants in the taxation process; 4) the policy should help limit the smoking prevalence, and not switching consumers to the illicit market[42].

The results of the analysis of the excise policy impact on the illicit tobacco market in the EU in recent years are also indicative. According to *KPMG study, in 2024*[43]*, compared to 2021*[44]*, the level of the illicit cigarette trade in Europe increased from 8.1 to 10%*. However, despite this general trend, the situation in EU countries developed differently. ***Some of the highest levels of the illicit trade and (or) their significant increase were observed in countries with the highest excise taxes on cigarettes*** *– Ireland, France, Finland, Belgium and the Netherlands* (Table 4.3).

The top five EU "leaders" in terms of the share of illicit cigarettes in total consumption also include *Latvia* and *Lithuania*, which have sharply increased the excise duty on such products to the level that is higher than in Spain and Luxembourg, which are at the bottom of the list of countries with almost no illicit cigarettes. *Estonia*, on the contrary, has managed to somewhat reduce the illicit tobacco market. For the Baltic countries, smuggling from the Russian Federation and Belarus, where cigarette excise taxes are much lower, creates additional risks. Only the war in Ukraine has significantly reduced the "transparency" of the borders with these aggressive neighbors.

Greece has not been able to completely overcome the illicit market even with a relatively low excise duty on cigarettes and a refusal to increase it (after a sharp jump) for 10 years. *Cyprus* has also not increased the mentioned excise duty for a

[41] Causes and Control of Illicit Tobacco. Alvarez & Marsal. Second Edition, 2019. URL: https://www.alvarezandmarsal.com/sites/default/files/causes_and_control_of_illicit_tobacco_report_ed_2.pdf
[42] Handbook of Tobacco Taxation: Theory and Practice, by Arthur B. Laffer. Pacific Research Institute for Public Policy. 2014. 392 p.
[43] Illicit cigarette consumption in Europe. Results for the calendar year 2024. KPMG. URL: https://www.pmi.com/resources/docs/default-source/itp/illicit-cigarette-consumption-in-europe-2024-results.pdf?sfvrsn=4ad3ac8_6
[44] Illicit cigarette consumption in the EU, UK, Norway and Switzerland. 2021. KPMG. URL: https://www.pmi.com/resources/docs/default-source/itp/kpmg-eu-illicit-cigarette-consumption-report-2021-results.pdf?sfvrsn=5fe773b6_6.

long time. It is not known what would have happened if the excise policy in these countries with a well-established shadow tobacco "business" had been different. *The consequences of tax shocks can be so devastating that they cannot be overcome in decades*.

Table 4.3

The impact of taxation on the illicit cigarette trade level in EU countries in 2021-2025

№	EU countries	Illicit cigarette trade level			Minimum excise duty on cigarettes, euros/thousand units		
		2021, %	2024, %	Difference	2021	2024	2025
1	France	29	38	+ 9	336,7	371,4	**378,8**
2	Ireland	17	32	+ 15	414,24	512	**533,9**
3	Finland	14	20	+ 4	312	353,6	**389,6**
4	Latvia	16	20	+ 4	121,4	156,3	171,9
5	Lithuania	19	18	- 1	115,5	138,0	149,7
6	Greece	24	18	- 6	117,5	117,5	117,5
7	Netherlands	18	18	-	243,25	293,6	**390,4**
8	Belgium	5	15	+ 10	219,99	326,5	**353,9**
9	Cyprus	14	14	-	121,5	121,5	121,5
10	Hungary	4	13	+ 9	109,2	104,5	117,5
11	Sweden	7	8	+ 1	154,5	161,9	187,6
12	The Czech Republic	3	8	+ 5	118,88	173	182
13	Denmark	7	7	-	233,2	260,3	**251,6**
14	Estonia	10	7	- 3	145,6	169,1	186,7
15	Slovenia	8	6	- 2	120	141	150
16	Romania	8	6	- 2	112,24	134,52	140,7
17	Malta	9	5	- 4	165	165	165
18	Slovakia	3	5	+ 2	116,5	148	148
19	Croatia	6	5	- 1	117,41	117,9	124,2
20	Austria	4	4	-	153,63	163	175
21	Poland	5	4	- 1	104,09	129,8	157,7
22	Spain	3	3	-	131,5	131,5	150
23	Portugal	7	2	- 5	136,75	151,88	151,88
24	Італія	2	2	-	-	204,23	209,3
25	Germany	2	2	-	165,22	228,8	**241,6**
26	Luxembourg	1	1	-	118,3	136,1	144,5
27	Bulgaria	2	1	- 1	90,5	98,9	107,1

Source: prepared based on KPMG and European Commission data

Let us analyze the development of the illicit cigarette market *in countries with a minimum excise duty on them, which already exceeds the future European baseline*

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level proposed by the European Commission – ***215 euros*** per thousand units. Three of them (*Ireland, Denmark and Finland*) are countries with most of their territory washed by the sea, which is a barrier to the entry of smuggled cigarettes. However, the high excise duty (legal cigarettes price) in them still attracts (or has increased) the attention of tobacco criminals. In particular, the share of the illicit cigarette market in Ireland, where the excise duty on such products is significantly higher than in other EU countries and which has a land border only with the United Kingdom (where the excise duty on cigarettes is also high) in 2021-2024, increased from 17 to 32%.

In contrast, *France* which is in continental Europe and has neighbors with lower excise duties (prices) on cigarettes. Such differences attract smugglers, but recently they are not the ones that create the biggest problems in the French tobacco market. There is a prevalence of counterfeiting in the country – in 2024 7.8 billion units of counterfeit cigarettes were consumed. The high excise duty has increased the profitability of illicit production of such products so much that it made it possible to find "weak links" in the law enforcement system. It has caused a serious failure. Moreover, these are not Ukrainian law enforcement agencies, the institutional capacity of which needs to be increased. Back in 2020, France headed the anti-rating of EU countries with the highest share of illicit cigarettes in the total volume of their consumption, and in 2024 it consolidated its "leading" position in it with an astronomical figure of 38%.

In addition, cases[45] of detection of clandestine cigarette productions, where Ukrainian citizens work, have become more frequent in *Belgium* and *the Netherlands*, which are territorially close to France. Both countries have some of the highest excise duty on cigarettes in the EU, and Belgium also allowed a shock increase in the tax. This leads to another conclusion: *if a "hotbed" of counterfeit tobacco "ignites" in a country, it may "become cramped" within the national market and it will try to cross its borders.*

The examples of Belgium, Ireland, and France show that ***a sharp increase in excise duties negatively affects the development of the tobacco market and leads to significant losses of budget revenues even in countries with high purchasing power of the population and institutional capacity of control bodies and the law enforcement system.***

Among the new EU countries, the largest increase in the illicit cigarette trade level was observed in *Hungary* and *the Czech Republic* in 2021-2024. In the Czech Republic this occurred in conditions of high excise rate increase.

[45] Illicit cigarette trade: trends and countermeasures. Koshchuk T., Pasichnyi M. / edited by T. Koshchuk, Growford Institute, Kyiv: 2025. 76 pages URL: https://www.growford.org.ua/research/nelegalna-torgivlya-sygaretamy-tendentsiyi-ta-zahody-protydiyi/

Now let's look at the bottom of Table 4.3 with the countries with the lowest share of illicit cigarettes in the total volume of their consumption. These are *Austria*, *Luxembourg*, *Italy*, *Spain* and *Portugal*, where the minimum excise duty on such products in 2025 was less than 215 euros per thousand units, as well as countries with some of the lowest excise taxes in the EU and relatively low purchasing power of the population – *Poland* and *Bulgaria*. A balanced excise policy helps them to keep illicit cigarettes under control.

The above-mentioned shows that *proposed new EU rules on minimum excise duty on cigarettes are* ***strict*** *and will require most countries to increase rates. Even considering* ***the price level index***. Let's take a range of rates for countries with opposite levels of economic development: for ***Denmark*** in *PLI* 2024 the minimum excise duty on cigarettes will be ***245.9 euros per thousand units***, for Bulgaria – ***186.1 euros per thousand units***.

Considering that the minimum rates *corresponding to new requirements should come into force from 2028*, a sharp increase of the excise duty on cigarettes by 35-60 euros should occur in Lithuania, which is problematic in terms of illicit trade of such products, as well as in more prosperous in this context countries such as Sweden, Slovenia, Romania, Malta, Slovakia, Austria, Poland, Spain, Portugal (Figure 4.1). A number of other EU countries – Greece, Hungary, Cyprus, Croatia and Luxembourg – will be forced to make even more radical changes to rates, and *Bulgaria will have to almost double its excise duty on cigarettes*.

In our opinion, *the high rate of increase in minimum excise duty rates on cigarettes in most EU countries will create a threat of* ***surges in counterfeit production and smuggling of such products*** *(for example from Asia) for these member states, and* ***Bulgaria, Hungary and Croatia may become a hub for tobacco criminals***. *However, such rates increase will not improve the situation for countries that already have high excise duties and suffer from the illicit cigarettes prevalence.*

It is also important to keep in mind that *the new excise rules must be implemented not only by EU countries, but also by the candidate countries for accession*, some of which have lower purchasing power, such as Romania or Croatia. These countries include *Albania*, *Bosnia and Herzegovina*, *Moldova*, *North Macedonia*, *Serbia and Montenegro*, where the illicit cigarette trade level in 2024 was from 1% to 8%, as well as *Ukraine*, which has significant problems with the shadow tobacco market (Subsection 2.2). For the candidate countries for accession to the EU, *the risks of illicit cigarette trade surges will be especially high*.

Therefore, a very ***likely scenario in case of a requirement to ensure achievement of the minimum excise duty on cigarettes 215 euros per thousand units (adjusted on the price level index) as early as 2028 even more of Europe will fall into the trap of illicit.***

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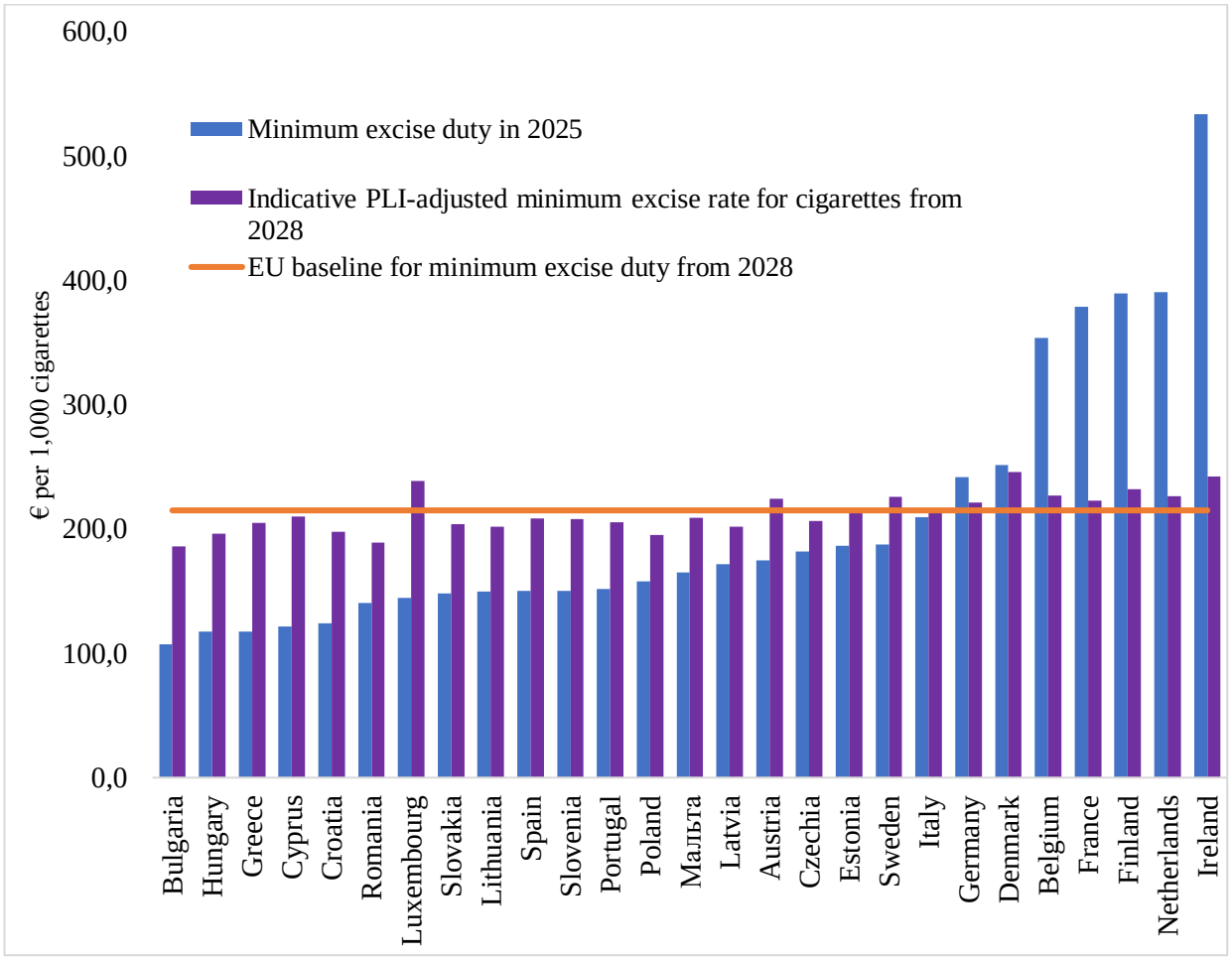


Figure 4.1 Minimum excise duties on cigarettes in the EU member states in 2025 and the European Commission proposed national minimum rate for 2028, adjusted on PLI 2024

Source: European Commission. Taxes in Europe Database. URL: https://trade.ec.europa.eu/access-to-markets/en/content/excise-duties#toc_3; Price level indices. Eurostat. URL: https://ec.europa.eu/eurostat/data-browser/view/tec00120/default/table?lang=en

A sharp increase in cigarette prices may also cause *switching consumers to alternative products, including* ***electronic cigarettes, the liquids market of which is developing significantly or mainly in the illicit segment in both Europe and Ukraine***[46]**.**

As a result, instead of desired reduction in cigarette consumption and budget revenues increase, we may expect a significant revival of illicit trade in tobacco and nicotine-containing products with all the negative consequences that arise from this.

Preventing such an undesirable situation is possible under the following conditions:

[46] Illicit trade in e-cigarette liquids: UPDATES. Koshchuk T., Pasichnyi M. / edited by T. Koshchuk, Growford Institute, Kyiv: 2025. 58 pages. URL: https://www.growford.org.ua/research/nelegalna-torgivlya-ridynamy-dlya-elektronnyh-sygaret-updates/

1. Postponement of coming into force the application of the new minimum excise duty on cigarettes of "215 euros" to 2032, which is the date of entry into force of the final taxation rates on other tobacco and nicotine-containing products.

2. Provide additional transitional periods for countries with low purchasing power, as it was already implemented during the implementation of the Council Directive 2011/64/EU (Subsection 2.1).

3. Increase flexibility in the formula for calculating the minimum excise duty on tobacco and nicotine-containing products for better consideration of countries specifics (for example, in the least developed countries, not 1/3, but 1/2 of the rate may be adjusted on PLI).

It is possible to choose not one, but several proposed solutions. We believe that it is necessary to carefully weigh all the pros and cons of the European Commission's initiative in the field of changing the excise taxation rules on tobacco and nicotine-containing products and ensure that the final version of the relevant provisions of the directive to be balanced in terms of achieving health protection goals, budget filling, and taking into account risks of illicit trade in such products.

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5. Recommendations on excise duty rates on tobacco and nicotine-containing products in Ukraine

We will propose ways to improve Ukraine's excise policy.

5.1. Modeling the consequences of implementing the European Commission's initiative on cigarette taxation

The European Commission's vision for the future of cigarette taxation is important for studying for policymakers and experts in Ukraine. The European approach to the formation and implementation of the excise policy is based on the principles of predictability and consistency, which must be taken into consideration when taking relevant decisions in Ukraine to ensure their effectiveness.

Figure 5.1 presents the minimum excise duty on cigarettes in EU countries and Ukraine as of October 1, 2025. The average value of this indicator for the EU-27 was 207.3 euros per thousand units and it is significant that *only in eight member states the actual indicator exceeds it*.

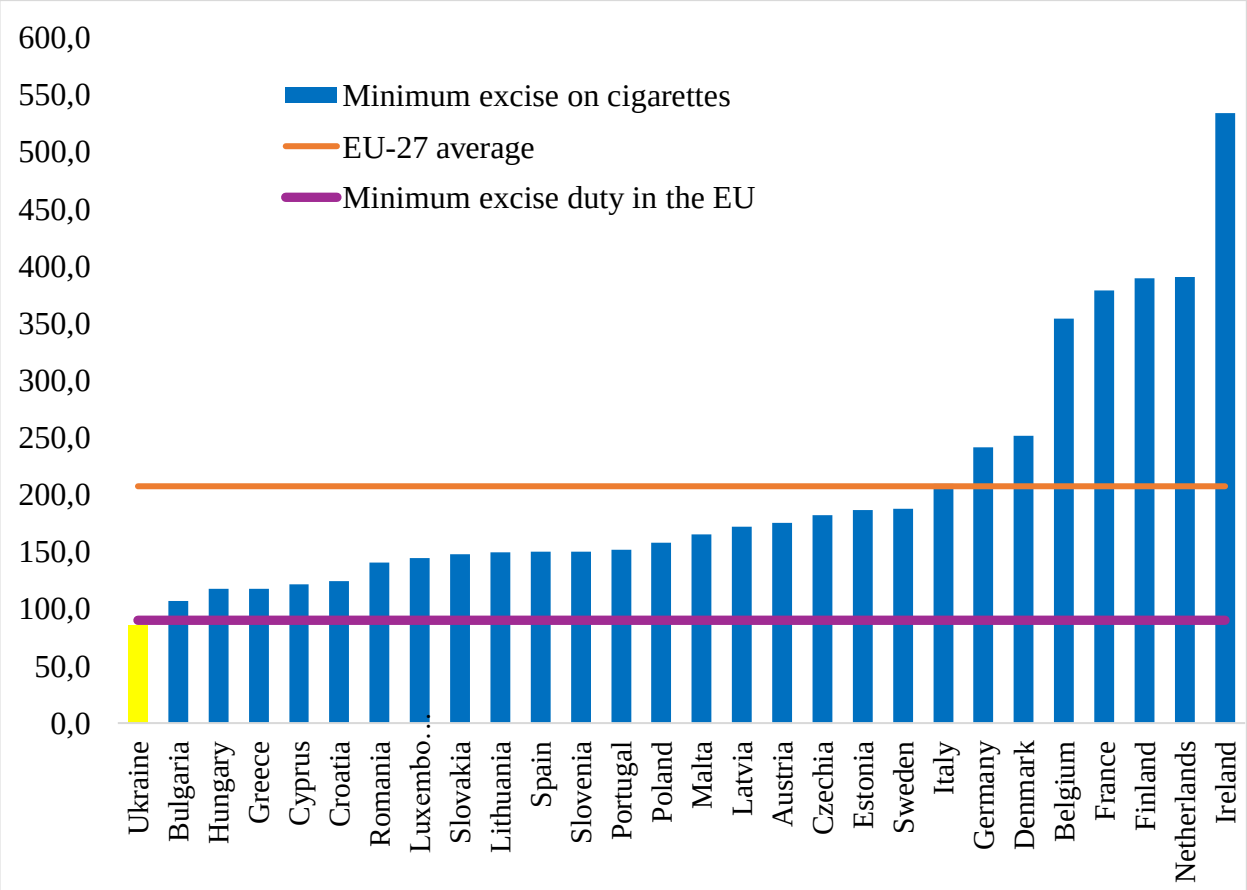


Figure 5.1 Minimum excise duty on cigarettes in the EU member states and Ukraine as of 1 October 2025 (EUR/1,000 cigarettes)

Source: prepared by the authors based on the European Commission and the Ministry of Finance of Ukraine data

The logic of the drafters of the *Proposal for a Council Directive on the structure and rates of excise duties applicable to manufactured tobacco and related products (recast)*[47] (hereinafter referred to as the Proposal) is that to set the baseline of the minimum excise duty on cigarettes at a rate close to the average in the EU-27 in 2025, granting for countries three years (2026-2028) for gradual rates increase. Therefore, for 19 European economies, the increase in the minimum excise duty is a matter of urgency. Even in Sweden, this indicator is lower than the proposed one. The challenges associated with the further ***tax shock*** will also affect many countries in Central and Eastern Europe, Austria, Luxembourg, Portugal, Spain, Greece, Cyprus and Malta. Some countries will be forced to almost double the excise duty on cigarettes in a limited time frame. As is seen from the example of Table 4.3, Section 4 the tax shocks are often accompanied by a sharp increase in the illicit cigarette trade. This is a significant problem for many countries and causes multi-billion dollars budget losses.

Figure 5.1 illustrates that the countries of Central and Eastern Europe, whose economies had and have many common features with the Ukrainian one, are characterized by a significantly lower level of the minimum excise duty on cigarettes compared to the countries of Western Europe and the Nordic countries. To mitigate the significant increase in rates, the European Commission proposed to apply an innovative tool of adjusting 1/3 of the excise duty rate on tobacco products on *PLI (Price Level Index)*, taking into account the disparities in socio-economic development and purchasing power parity of the countries.

The lowest *PLI* is currently fixed in Bulgaria. In 2024[48], this indicator was 59.7, which is 40.3 points below the EU-27 average; in Romania – 63.7 (36.3 points lower); in Poland – 72.2 (17.8 points lower); in Hungary – 73.5 (26.5 points lower); in Croatia – 76.3 (23.7 points lower); in Lithuania – 81.6 (18.4 points lower); in Latvia – 81.8 (18.2 points lower); in Slovakia – 84.7 (15.3 points lower); in Greece – 86.0 (14.0 points lower); in Portugal – 87.0 (13.0 points lower); in the Czech Republic – 88.4 (11.6 points less); in Slovenia – 90.2 (9.8 points less); in Spain – 90.9 (9.1 points less); in Malta – 91.6 (8.4 points less); in Cyprus – 92.8 (7.2 points less). For all mentioned countries, should be applied a lower minimum excise duty on cigarettes than the basic one – 215 euros per thousand units; for other 10 EU countries (except Estonia) – a higher one.

The potential minimum excise duty on cigarettes, as it is required by the Proposal, is shown in Figure 5.2. The highest indicator after adjustment on *PLI-2024* can be applied to Denmark, the lowest to Bulgaria.

[47] Document published on July 16, 2025
[48] Price level indices. Eurostat. URL: https://ec.europa.eu/eurostat/databrowser/view/tec00120/default/table?lang=en

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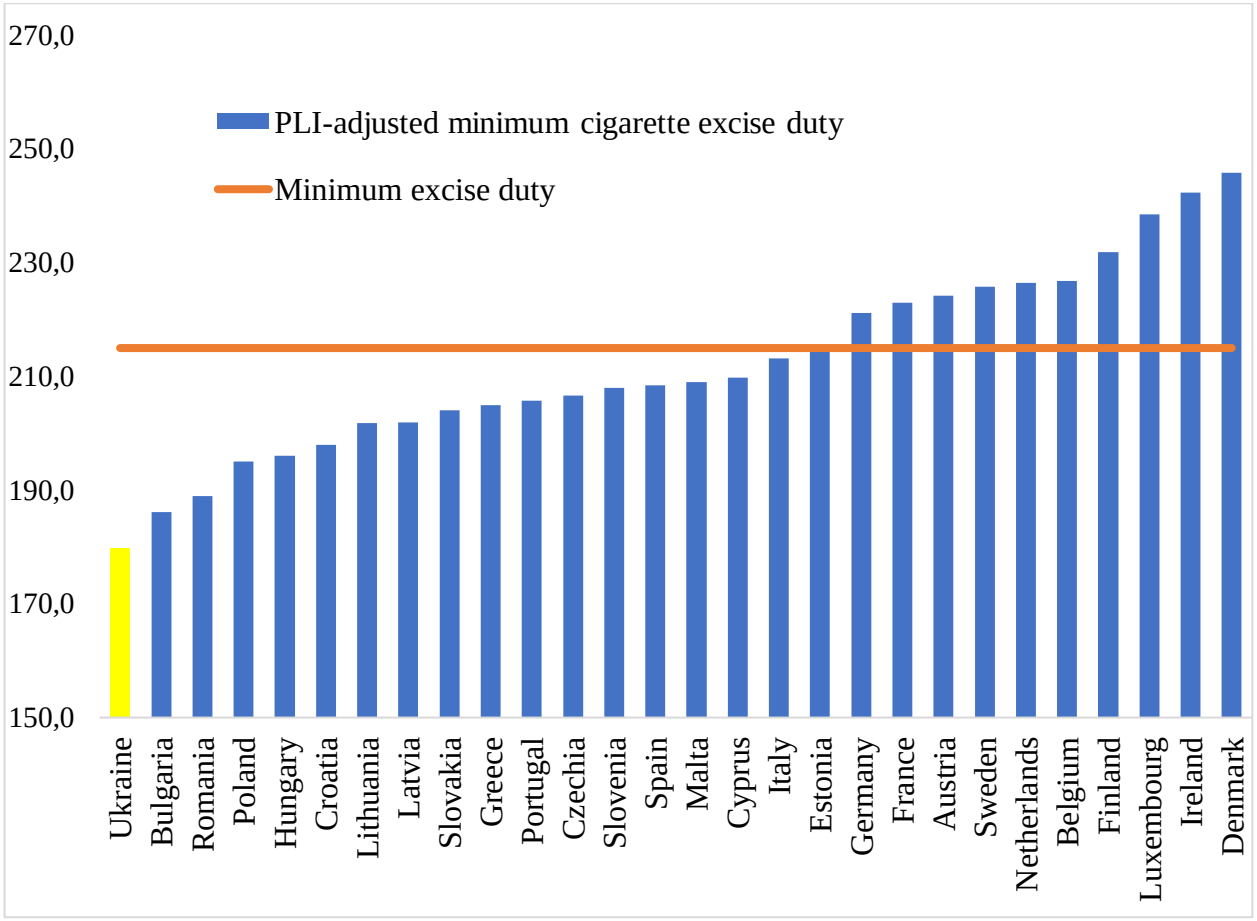


Figure 5.2 Minimum excise duties on cigarettes in EU countries and Ukraine under the Proposal (EUR/1,000 cigarettes)

Source: prepared by the authors based on their own calculations https://ec.europa.eu/eurostat/data-browser/view/tec00120/default/table?lang=en; https://taxation-customs.ec.europa.eu/document/download/420ebf11-933d-46c0-8915-5a306c6bcb47_en?filename=COM_2025_580_1_EN_ACT_part1_v7.pdf;

Despite the need to increase the excise duty on cigarettes not only in EU countries but also in Ukraine, which is the requirement of its European integration, such measures require clear logic and strategic planning for several reasons.

First, we have the experience of the previous revision of European standards. In Subsection 2.1, it was mentioned that several EU countries were given a transitional period to raise the minimum excise duty on cigarettes to 90 euros per thousand units by December 31, 2017. These countries had 2011-2018 for adjusting the rates. A new increase in the minimum excise duty in the EU is expected from 2028, in view of that all countries have been given three years to implement the "215 euros" rule.

In *Ukraine*, considering entry into force of a new schedule of gradual increase in the excise duty rates on cigarettes from March 2025, the target of 90 euros is expected to be achieved from 2028. At the same time, taking into account the European Commission's initiative to update the relevant standard adjusting on *PLI*, *the Ukrainian minimum excise duty on cigarettes in the future may need another increase to approximately* ***180 euros*** *per thousand units*.

Second, the full-scale war continues in Ukraine, which is destructive for the economy, infrastructure, population welfare and reduces its purchasing power. In 2024-2025, wages for many categories of workers almost did not grow, despite the increase in their average level in Ukraine. In 2024, the average wage in the EU was 39.8 thousand euros per year or 3.3 thousand euros per month[49]. In Ukraine, the average monthly wage in 2024 was 21,473 hryvnias, which is equivalent to almost 500 euros. Thus, *the average wage in the EU and Ukraine differs by* ***6.6 times***! In addition, the lowest wage level in the EU was fixed in Bulgaria – 1,280 euros per month, which is 2.6 times higher than the similar indicator in Ukraine.

It seems illogical that for Ukraine, a candidate for EU accession, which has significantly lower social standards and guarantees compared to EU countries, will be applied a minimum excise duty on cigarettes, close in rate to the current average European one.

Third, Table 2.3 of Section 2 summarizes cases of surges in illicit cigarette trade and tax revenues decrease in Central and Eastern European countries that have sharply increased excise rates in attempt to quickly implement the "90 euros" rule.

These cases are so significant that even some EU-15 "old-timers" are now afraid of a new tax shock. In particular, *Portugal* has officially announced its objection to the Proposal regarding the sharp increase in the minimum excise duty on cigarettes, warning that the proposed changes will cost the country up to 1.5 billion euros in lost revenues. It is expected that the price of a cigarette pack will increase by 1.22 euros[50]. *Greece* has suggested the European Commission to find compromises on the minimum excise duty on cigarettes to avoid illicit tobacco market expansion[51].

During the discussions of the Proposal in the European Parliament's Subcommittee on Tax Matters (*FISC*), experts and MEPs expressed concerns that the European Commission's initiatives do not take into account their possible economic and social consequences regarding the spread of organized crime, reduced employment and production.

In particular, ***the EU is vulnerable to cigarette smuggling across borders with non-EU countries that do not align their excise policies with European standards***. This is primarily the case with *Belarus*. The prevalence of balloons carrying contraband across the borders of Belarus and Lithuania has caused chaos at airports. These incidents point to persistent, large-scale smuggling networks supported by Belarusian authorities. Flying at an altitude of around 13 km, the balloons became very

[49] Annual full-time adjusted salary in EU up 5.2% in 2024. URL: https://ec.europa.eu/eurostat/web/products-eurostat-news/w/ddn-20251112-1#:~:text=In%202024%2C%20the%20average%20annual,Ireland%20(%E2%82%AC61%20100)
[50] Portugal Latest to Reject EU Tobacco Tax Hike Proposal. URL: https://tobaccoreporter.com/2025/08/04/portugal-latest-to-reject-eu-tobacco-tax-hike-proposal/
[51] Greece cautious on new smoking taxation. URL: https://www.ekathimerini.com/economy/1283715/greece-cautious-on-new-smoking-taxation/

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numerous in late October 2025, causing the suspension of operations at several airports in the EU. According to the European Commission's estimates, the budget revenues losses of EU countries from the illicit cigarette market have amounted to around 9 billion euros per year, and 3.5 billion euros[52] from the "shadow" of other tobacco and nicotine-containing products.

All of the above-mentioned makes it necessary to introduce a reasonable and balanced approach regarding increasing the excise duty on cigarettes in Ukraine, which should be extended over time to ensure tax revenues increase and prevent the illicit tobacco market expansion.

Let us consider two main scenarios on increasing the minimum excise duty on cigarettes, taking into account the Proposal's provisions and the need to align the excise duty rate in Ukraine with the minimum actual level in the EU.

Scenario 1. Increasing the minimum excise duty on cigarettes to 180 euros per thousand units (considering the adjustment coefficient) from January 1, 2028.

We consider this scenario to be less likely, as it involves serious risks for filling the state treasury due to *the significant surge in the illicit cigarette market and/or the substitution of cigarettes with illicit liquids for electronic cigarettes (vapes)*. There are several reasons for this.

First, Ukraine will have to increase the minimum excise duty on cigarettes to 180 euros within a year and a half (from July 1, 2026 to January 1, 2028). At the same time, the Proposal has not yet been finally approved, and *there is no direct requirement for the implementation of its provisions for EU candidate countries*. In case the excise duty increases evenly in three stages the corresponding schedule may be the same as presented in Table 5.1.

Table 5.1

The minimum excise duty on cigarettes in Ukraine under Scenario 1

Measurement unit	Rate from 01.01.2026	Rate from 01.07.2026	Rate from 01.01.2027	Rate from 01.01.2028
euros per thousand units	82,0	114,6	147,2	180,0
growth rate, %	- 4,1	39,8	28,4	22,3
hryvnias per thousand units	4016,82	5638,32	7301,10	9216,26
growth rate, %	7,1	40,4	29,5	26,3

Source: prepared by the authors

[52] Experts and MEPs express concerns for the revised Tobacco Excise Directive (TED). URL: https://www.eureporter.co/politics/european-parliament-2/2025/11/27/experts-and-meps-express-concerns-for-the-revised-tobacco-excise-directive-ted/

Considering that from January 1, 2026, when paying excise duty on tobacco products is actual the official euro to hryvnia exchange rate as of July 1, 2025 – 48.9856 hryvnias[53], the minimum excise duty on cigarettes is 4016.82 hryvnias per thousand units against the indicator of 3748.22 hryvnias per thousand units (43.6855*85.8) in July-December 2025[54]. Therefore, despite the fact that the coefficient of 1.1 has not been applied to the minimum excise duty, which was in effect from April 1 to December 31, 2025 due to failure to meet the requirement for the share of excise duty in the weighted average retail price of cigarettes to be at least 60%, the increase in the tax burden was 6.3% (due to devaluation processes). The forecasts of the Ministry of Economy of Ukraine[55], the Government of Ukraine[56], the IMF[57] and the expert community[58] show that the Ukrainian hryvnia is expected to devaluate in the medium term. Considering the consensus forecast for the euro-hryvnia exchange rate, the actual minimum excise duty on cigarettes will grow at a higher rate than the euro rates.

According to Scenario 1, from 2028 the minimum excise duty on cigarettes in hryvnia equivalent will be 2.3 times higher compared to its rate as of January 1, 2026 (in conditions of moderate devaluation). At the same time, in case of deterioration in the socio-economic conditions the situation may be different, which will lead to even greater increase in the tax burden on cigarettes.

Second, the increase from April 1 to December 31, 2025, of the minimum excise duty on cigarettes by 10% to 85.8 euros per thousand units caused a significant increase in prices for such products (for example, in November 2025, premium cigarettes cost about 3 euros per pack). This caused an increase in the share of the illicit cigarette market[59] compared to 2024, despite countermeasures. *Ukraine ranks second in Europe in terms of the volume of illicit cigarettes following France*[60]*. The cigarette market "shadow" cost the state 26.5 billion hryvnias in tax shortfalls only in 2025.*

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[53] Official exchange rate of the hryvnia against foreign currencies as of 07.01.2025 URL: https://bank.gov.ua/ua/markets/exchangerates?date=01.07.2025&period=daily

[54] The letter from the State Tax Service of Ukraine from July 28, 2025 № 18610/7/99-00-21-03-03-07 URL: https://tax.gov.ua/zakonodavstvo/podatkove-zakonodavstvo/listi-dps/print-79630.html

[55] Issue "Ukraine: Challenges and New Opportunities for Restorative Growth. Consensus Forecast" (April 2025) URL: https://me.gov.ua/view/c9290a24-b108-46d9-af29-f2d13587f6cb.

[56] Budget declaration for 2026-2028. URL: https://mof.gov.ua/storage/files/%D0%91%D1%8E%D0%B4%D0%B6%D0%B5%D1%82%D0%BD%D0%B0%20%D0%B4%D0%B5%D0%BA%D0%BB%D0%B0%D1%80%D0%B0%D1%86%D1%96%D1%8F%20%D0%BD%D0%B0%202026-2028%20%D1%80%D0%BE%D0%BA%D0%B8.pdf

[57] World Economic Outlook (October 2025). URL: https://www.imf.org/en/publications/weo/issues/2025/10/14/world-economic-outlook-october-2025

[58] Difficult 2026. Shelling and crop failures worsened Ukraine's economic prospects for the next year and a half. URL: https://forbes.ua/money/vazhkiy-2026-y-obstrili-ta-nevrozhai-pogirshili-ekonomichni-perspektivi-ukraini-u-nastupni-pivtora-roku-prognoz-devyati-analitichnikh-tsentriv-28072025-31586

[59] Monitoring of illicit trade in tobacco products in Ukraine 2025. Wave 4. URL: https://www.kantar.com/ua/inspiration/ait/ait-wave-4-2025

[60] Illicit cigarette consumption in Europe. Results for the calendar year 2024. KPMG. URL: https://www.pmi.com/resources/docs/default-source/itp/illicit-cigarette-consumption-in-europe-2024-results.pdf?sfvrsn=4ad3ac8_6

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In one of our studies[61] is concluded that 1% increase in cigarettes price leads to an increase in the volume of their illicit circulation by 1.22%. Thus, *the increase in the excise duty and, as a result, cigarette prices in Ukraine has a significant impact on the size of the shadow market for such products.* As is described in Subsection 4.3 regarding the EU, an increase in the price of a cigarette pack by 1 euro caused an increase in their illicit market share from 5 to 12 percentage points, depending on the country.

The increase in Ukraine in 2026-2028 of the minimum excise duty on cigarettes from 82 to 180 euros per thousand units will lead to the increase in the price of a cigarette pack from 2 euros. Therefore, only because of the increase in the excise duty, the level of illicit cigarette trade may increase by 10-25 percentage points. However, the actual increase in the price of a cigarette pack in Ukraine will be higher than 2 euros (taking into account expected inflationary and devaluation processes, the increase in the amount of VAT and the retail excise in cigarettes price). The volume of the illicit market and budget losses in Ukraine may reach significant scales. The actual data on cigarette consumption in Ukraine in 2023-2024, as well as its estimated indicator in 2025 and forecast data for 2026-2028 in case of the Scenario 1 realization are presented in Figure 5.3.

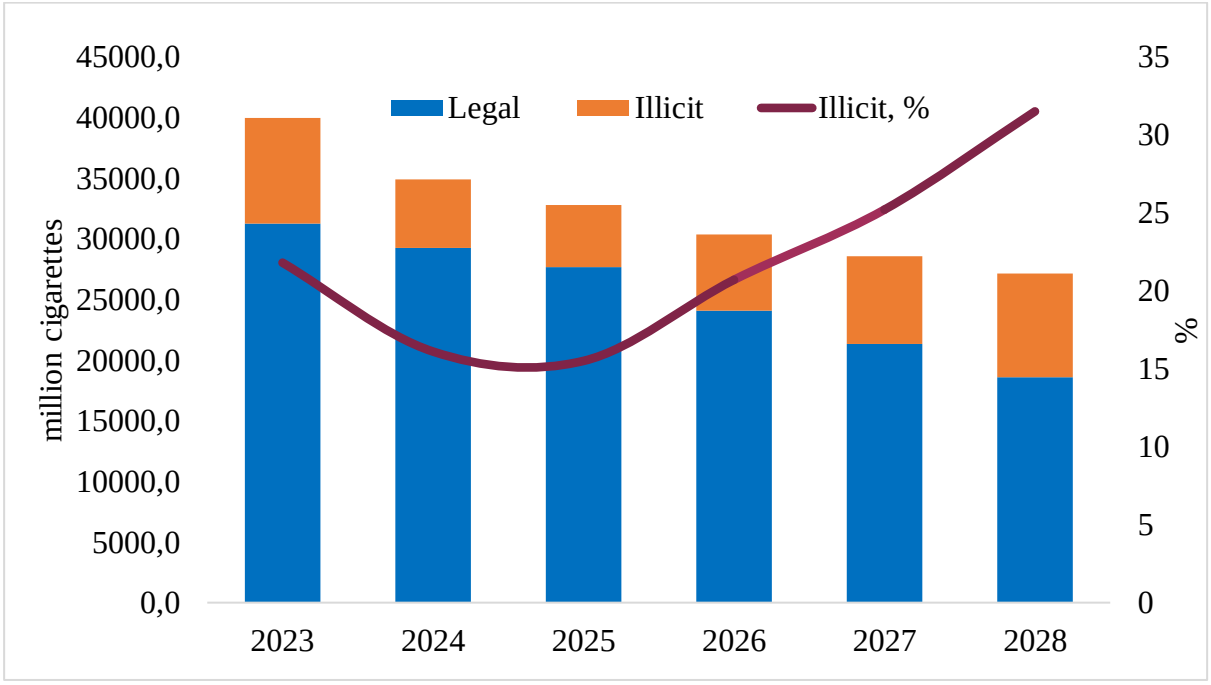


Figure 5.3 Cigarettes consumption in Ukraine over 2023-2028, by legal and illicit market (Scenario 1)

[61] Shvabiy, K. I., Makarenko, V. V., Novitska, N. V., Pasichnyi, M. D., & Khlebnikova, I. I. Improving the policy in cigarettes excise taxation and combating their illicit production and circulation in Ukraine. Kyiv : Growford Institute. 2021. 105 pages. URL: https://www.growford.org.ua/research/udoskonalennya-polityky-u-sferi-aktsyznogo-opodatkuvannya-sygaret-ta-prydiyi-yih-nezakonnomu-vyrobnyttsvu-ta-obigu-v-ukrayini/

Actual and estimated data on the legal cigarette market in 2023-2025 were calculated according to the data of the State Tax Service of Ukraine from 3-RS reports on cigarettes sold by domestic tobacco manufacturers on the domestic market and their imports. Illicit market indicators for this period were taken from *Kantar*[62] monitoring data on the illicit cigarette trade. Forecast cigarettes consumption indicators for 2026-2028 were calculated considering the price elasticity of demand for cigarettes. The elasticity coefficient is 0.3, which allows us to conclude that an increase in the price of cigarettes by 1% leads to decrease in demand for them by 0.3%.

Thus, in case of *Scenario 1* realization Ukraine is expected a rapid growth of the illicit cigarette market to 31.5% in 2028. Budget revenue losses (the excise tax, VAT, and the retail excise) in 2026 may amount to about 40 billion hryvnias, in 2027 – 67 billion hryvnias, *in 2028 – 100 billion hryvnias. In general, in 2026-2028, when implementing the tax shock approach, the budget may lose* ***more than 200 billion hryvnias***, which is unacceptable in conditions of severe restrictions on budget resources.

Third, in Ukraine there is an extremely low level of effectiveness in combating illicit trade of liquids for electronic cigarettes, as *evidenced by the indicator of the shadow segment of the market for such liquids at* ***over 90%***[6364]. Especially in conditions of sharp increase in excise taxes on cigarettes, smokers may switch to using vapes as much cheaper alternative. In addition, popular alternatives for vapers are products with flavors other than tobacco, prohibited by current legislation. The e-cigarette market is oversaturated with products that do not meet established standards and offers consumers cheap access to nicotine-containing products.

<u>Scenario 2.</u> Increasing the minimum excise duty on cigarettes to 180 euros per thousand units from January 1, 2035.

The following scenario is a priority in view of its fiscal effect and the importance of preventing a tax shock. It will allow us to confront more effectively the challenges of the illicit cigarette market and prevent its upward dynamics, that will ensure the growth of budget revenues and minimize tax losses. The schedule of the increase in the minimum excise duty on cigarettes under Scenario 2 is shown in Table 5.2.

[62] Monitoring of the illicit tobacco products trade in Ukraine 2025. Wave 4. URL: https://www.kantar.com/ua/inspiration/ait/ait-wave-4-2025
[63] Research on the electronic cigarette market in Ukraine. URL: https://www.kantar.com/ua/inspiration/ait/electronic-cigarettes-market-study-in-ukraine
[64] Illicit trade in e-cigarette liquids: UPDATES. Koshchuk T., Pasichnyi M. / edited by T. Koshchuk, Growford Institute, Kyiv: 2025. 58 pages. URL: https://www.growford.org.ua/research/nelegalna-torgivlya-ridynamy-dlya-elektronnyh-sygaret-updates/

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Table 5.2

The minimum excise duty on cigarettes in Ukraine under Scenario 2

Measure-ment unit	Rate from 01.01.2026	Rate from 01.07.2027	Rate from 01.01.2028	Rate from 01.01.2029	Rate from 01.01.2030	Rate from 01.01.2031	Rate from 01.01.2032	Rate from 01.01.2033	Rate from 01.01.2034	Rate from 01.01.2035
euros per thousand units	82,0	86,0	90,0	103,0	116,0	128,0	141,0	154,0	167,0	180,0
growth rate, %	- 4,1	4,9	4,7	14,4	12,6	10,3	10,2	9,2	8,4	7,8
hryvnias per thou-sand units	4016	4265	4608	5484	6405	7287	8364	9318	10307	11442
growth rate, %	7,1	6,2	8,0	19,0	16,8	13,7	16,2	11,4	10,6	11,0

Source: prepared by the authors

The increase of the rate in 2026-2028 is stipulated by the current schedule on increasing the minimum excise duty on cigarettes. Such step is economically justified as it is necessary to ensure fiscal sustainability and minimize risks for the market and the state. The largest of them are the size of the "shadow" and the insufficient effectiveness of the combat against illicit players on the cigarette market, who do not pay 26.5 billion hryvnias in taxes (in 2025). If the effectiveness of combating illicit cigarette trade is not increased, these losses will only increase. For reaching that there is need to strengthen the institutional capacity of state bodies. In war conditions, the priority should be reduction of budget losses, which are a reserve for financing programs to strengthen the country's defense capabilities.

In addition, the volume of ***almost completely illicit*** *market for electronic cigarettes and liquids for them* is growing. The number of vapers is increasing sharply[65], which is gradually manifested in a change in preferences and transition of consumers from traditional cigarettes to electronic ones. *This is confirmed by the results of a survey by the World Health Organization (hereinafter referred to as the WHO)*: cigarette consumption in Ukraine ***decreased*** from 22.2% in 2023 to ***17.8%*** in 2024, while the consumption of electronic cigarettes ***increased*** from 3.3% to ***5.3%***. In addition, young people aged 18-29 are the age group with the highest partial prevalence of tobacco and nicotine-containing products consumption. The largest consumption in this age category is: ***20.2%*** – electronic cigarettes (the amount has doubled over the year); ***14.2%*** – cigarettes (decrease by 32%)[66].

[65] The same.
[66] Tobacco and nicotine product use among adults in Ukraine – findings from a sociological survey among adults aged 18 years and over. WHO. 2025. URL: https://www.who.int/ukraine/uk/publications/m/item/tobacco-and-nicotine-

Therefore, without significant changes in combating against illicit market of e-cigarette liquids, the shadow market for nicotine-containing products will continue to grow due to the gradual absorption of the traditional cigarette market by vapes. As a result, this will be reflected in an increase in the volume of budget tax revenue losses.

Taking into account the above-mentioned, we propose to double the minimum excise duty on cigarettes (from 90 to 180 euros per thousand units) in stages over a period of seven years – from January 1, 2029 to January 1, 2035. We have developed a forecast of cigarette consumption indicators until 2035, in case of Scenario 2 implementation (Figure 5.4).

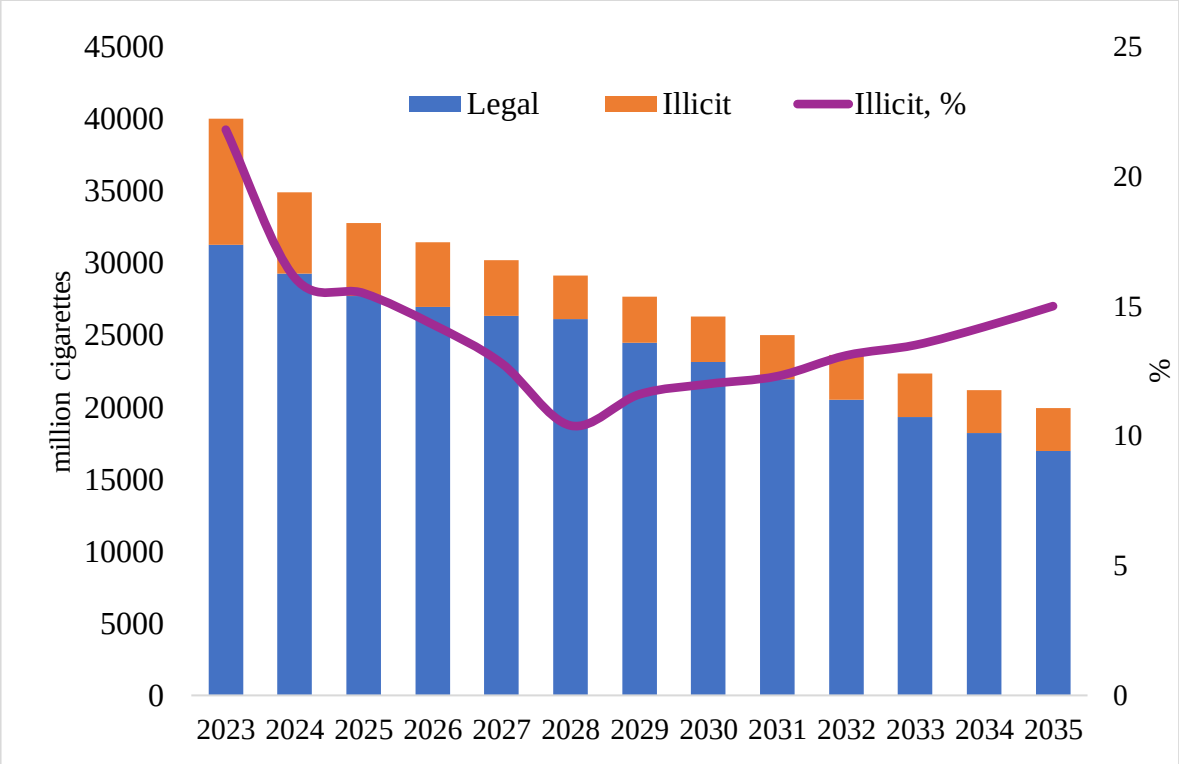


Figure 5.4 Cigarette consumption in Ukraine over 2023-2035, by legal and illicit market (Scenario 2)

The soundness and consistency of the excise policy in the field of tobacco products in 2026-2028 will allow gradually *reduce the share of the illicit cigarette market to **10.4%*** in 2028. Even taking into account expected increase in excise rates and devaluation of the national currency, *budget losses from the illicit cigarette market will decrease* from 26.5 billion hryvnias in 2025 to ***18 billion hryvnias*** in 2028. During this period, should be increased *the effectiveness of the combat against illicit cigarettes* by the Bureau of Economic Security, the State Tax Service, the National Police, the State Customs Service and the State Border Service, and their efforts should be coordinated more effectively. In addition, the development of the

product-use-among-adults-in-ukraine---findings-from-a-sociological-survey-among-adults-aged-18-years-and-over---comparative-analysis-of-the-2023-and-2024-survey-rounds

institutional environment of the state control over production and circulation of tobacco products will allow more effectively counteract the challenges of the illicit cigarette market also in 2029-2035.

A gradual increase in the minimum excise duty on cigarettes will contribute to a gradual decrease in smoking prevalence. In contrast, *a sharp increase in the excise duty* ***does not affect*** *the reduction of nicotine consumption,* as ***there is a switch of consumers into the illicit cigarette market and markets of other tobacco and nicotine-containing products.*** The experience of EU countries described in Subsections 2.1 and 3.4 shows that combating surges in the shadow cigarette market in conditions of tax shock is very difficult, if at all is possible. This requires allocating additional funding to control and law enforcement agencies (*an unpopular topic for society*), significant time costs, and suspending increase in the excise duty rates in future periods. Ukraine should take these lessons into account when forming and implementing its own excise policy.

The approach proposed in Scenario 2 with regard to increasing the minimum excise duty on cigarettes in Ukraine can ***be fixed*** either *by amending relevant norms to the transitional provisions of updated directive*, amending the text of the European Commission Proposal, or *by introducing the specified excise policy strategy in new agreements on Ukraine's accession to the EU*.

An alternative scenario for increasing the minimum excise duty on cigarettes may be ***amendments to the Proposal on application a correction coefficient to the price level index***.

Professor *Francesco Mosconi* emphasizes that the GDP per capita in Luxembourg is 8 times higher than in Bulgaria. Therefore, considering the correction coefficient for only 1/3 of the excise duty rate on cigarettes is insufficient and creates a significant imbalance among European countries[67].

We believe that for countries with *PLI* of up to 75.0 half of the excise duty rate may be fixed (while in the Proposal 2/3), and the other half (while in the Proposal 1/3) may be adjusted based on purchasing power parity.

The above-mentioned will allow Bulgaria, Romania, Poland and Hungary, as well as the EU candidate countries (including, of course, Ukraine), to transition more smoothly from the current rates to the new minimum excise duty standards on cigarettes defined by the Proposal. This will serve as a safeguard against the expansion of illicit markets for tobacco and nicotine-containing products.

Fixation the excise rules proposed by the alternative scenario in the text of updated directive by amending the Proposal *will allow Ukraine to meet the new EU requirements regarding the minimum excise duty on cigarettes even earlier than 2035.*

[67] Revision of the Tobacco Excise Directive (Council Directive 2011/64/EU). URL: https://www.europarl.europa.eu/cmsdata/300339/Francesco%20Moscone%20-%20PowerPoint%20Presentation.pdf

5.2. Setting differentiated excise duty rates for different product categories

In the excise policy should also be considered that *the market for traditional tobacco products, the main type of which are* ***cigarettes****, will gradually shrink*. And not only because the smoking prevalence will decrease. This would be an ideal, but, unfortunately, difficult scenario to implement in practice. The best option is if young people do not start, and smokers stop smoking. However, it is not easy to keep everyone from nicotine addiction, which has fashionable trends. More and more consumers choose *the novel products* – ***electronic cigarettes*** (e-cigarettes), ***heated tobacco*** (in Ukraine it is known by the term enshrined in law "electrically heated tobacco products", HTPs) and ***nicotine pads*** (pouches). The questions arise. How to tax them? If they displace cigarettes, are there threats for tax revenues related to the formation of their illicit markets?

There is an ongoing discussion whether this has been sufficiently considered in the approach to future taxation of tobacco and nicotine-containing products, which is presented in the European Commission Proposal and described in Subsection 4.1.

In particular, *the Taxpayers Association of Europe* believes that ***the practice of heated tobacco taxation at lower rates than cigarettes, which is used in EU countries, should be maintained***. Unlike electronic cigarettes, which are mainly imported into the EU, HTPs are manufactured in European countries. Accordingly, differentiation of the excise rates for heated tobacco and cigarettes *helps to avoid additional loopholes due to product interchangeability* and provides predictability for both consumers and national budgets[68].

The Minister of Economy and Finance of *Greece Kyriakos Pierakakis*, speaking at the meeting of the *EU's Economic and Financial Affairs Council (ECOFIN Council)*, proposed *to set lower excise duty rates than those initiated by the European Commission, not only on cigarettes but also on other tobacco and nicotine-containing products*, and a longer period for increasing the tax burden. Considering Greece previous experience and its geographical location, *a sharp increase in the excise duty would lead to increase in smuggling*[69].

According to the official position of *Portugal*, presented in the Proposal approximation of the excise duty on such novel products as heated tobacco and liquids for e-cigarette to the level of cigarette taxation contradicts the objectives of public health. The argument is that *it is important to ensure differentiation of taxation of*

[68] Revision of the Tobacco Excise duty Directive (TED) - take concerns seriously. TAE calls for revision and valid regulatory impact assessment. URL: https://www.taxpayers-europe.org/information/press/149-revision-of-the-tobacco-excise-tax-directive-ted-ted-take-concerns-seriously-tae-calls-for-revision-and-valid-regulatory-impact-assessment.html

[69] Greece cautious on new smoking taxation. URL: https://www.ekathimerini.com/economy/1283715/greece-cautious-on-new-smoking-taxation/

different types of tobacco and nicotine-containing products in order not to hinder the switch of consumers to novel products and to avoid the growth of illicit markets[70].

According to the Head of *the Directorate General for Taxation and Customs Union, Maria Elena Scoppio, e-cigarettes attract young people, creating risks for the healthcare sector and increasing harmful addictions*. At the same time, the European Commission's initiatives are considering not only medical aspects, but also *the need to eliminate distortions in the EU internal market*. Today, e-cigarette liquids are not subject to common European taxation, and EU countries apply different approaches in this area. Excise duty harmonization will contribute to increasing the effectiveness of the regulation policy of this market[71].

Liquids for electronic cigarettes should be taxed at least at the minimum level set for EU countries. The European Commission proposes to set two excise duty rates for them, the higher of which (*0.36 euros per 1 ml with subsequent adjustment on PLI*) is provided for liquids with a nicotine concentration of more than 15 mg/ml, in order to take into account the diversity of products and prevent tax avoidance through the use of "self-mixing" mixtures. This approach has a significant drawback. Despite the fact that a higher nicotine content causes greater harm to health, *state control bodies will not be able to carry out numerous checks regarding nicotine content to establish the correctness of calculation and excise duty payment*.

New EU rules on e-cigarette liquids taxation should take into account the high level of shadowing of their market and the complexity of combating this phenomenon[72].

In Ukraine, the excise duty rate on all e-cigarette liquids, regardless of nicotine concentration, is 0.3 euros per 1 ml, corresponding to the minimum higher excise duty rate for such products in Bulgaria (after adjustment on PLI-2024). This means that *our country* ***is already meeting the future European standards*** in this area.

It is not necessary to apply differentiation if the single rate corresponds to the level of the highest of the national minimum rates. Ukraine should maintain a single excise duty rate for all e-liquids in the future.

The differentiation of excise duty rates on heated tobacco and cigarettes in Ukraine is in line with the practice of EU countries (see Section 3) and the provisions of the Proposal. At the same time, Ukraine is one of the countries with one of the smallest differences in the level of excise duty on these types of products in Europe.

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[70] Portugal Latest to Reject EU Tobacco Tax Hike Proposal URL: https://tobaccoreporter.com/2025/08/04/portugal-latest-to-reject-eu-tobacco-tax-hike-proposal/

[71] Single market, public health, risk of illicit trade: European Parliament questions EU tobacco tax reform. URL: https://www.eunews.it/en/2025/11/20/single-market-public-health-risk-of-illicit-trade-european-parliament-questions-eu-tobacco-tax-reform/

[72] Illicit trade in e-cigarette liquids: UPDATES. Koshchuk T., Pasichnyi M. / edited by T. Koshchuk, Growford Institute, Kyiv: 2025. 58 pages. URL: https://www.growford.org.ua/research/nelegalna-torgivlya-ridynamy-dlya-elektronnyh-sygaret-updates/

From March 25 to December 31, 2025, the excise duty rate on heated tobacco in Ukraine was 70.4 euros per thousand units; for excise purposes from July to the end of 2025 was used the official euro-hryvnia exchange rate established on January 1, 2025 (43.6855 UAH per 1 euro)[73]. In the second half of the year, the excise rate was actually 3075.46 hryvnias per thousand units. *From January 1, 2026 the rate of 70.8 euros per thousand units is applied to HTPs* but is used the euro-hryvnia exchange rate on July 1, 2025 (48.9856 hryvnias to 1 euro). Accordingly, *excise duty is paid at a rate of 3,648.18 hryvnias per thousand units*, and the difference in the level of excise duty at the end of 2025 and the beginning of 2026 in hryvnia equivalent is 12.8%, which is higher than the average annual consumer price index in 2025 (8.0%).

Taking into account the requirements of the Proposal for adjusting the rates on *PLI, **in 2032 the excise duty on heated tobacco in Ukraine should increase to approximately 90.4 euros per thousand units*** (base rate – 108 euros per thousand units). Based on the assumptions regarding the devaluation of the hryvnia set out in Subsection 5.1, we conclude that this will correspond to the level of 4,628.61 hryvnias.

The current excise duty increase schedule in Ukraine for 2025-2028 provides that *in 2028 the rate for HTPs will be 72 euros per thousand units*. Thus, in 2029-2032 the excise duty on heated tobacco *should increase **by 18.4 euros***; it will be possible to increase this rate by 4.6 euros each year to reach the threshold of 90.4 euros per thousand units. This demonstrates ***high readiness of our state to implement future EU rules and shows that gradual, balanced increase in the excise duty on HTPs is achievable***.

In EU countries in 2025, the difference in excise duty rates on heated tobacco and cigarettes was on average ***52%***. According to the position of the European Commission, in 2032, such differentiation could be ***50%***. At the same time, *in Ukraine in 2026 the excise duty on HTPs is 14% lower compared to cigarettes and only in 2028 this indicator will increase to **20%*** (when the minimum excise duty on cigarettes will be 90 euros per thousand units). *In 2025, the excise duty rate on heated tobacco in Ukraine exceeded such rate in 13 EU countries.* Meeting the Proposal's requirements regarding HTPs will create significant difficulties for several of these countries (Figure 5.5).

In Ukraine, the differentiation of excise rates on heated tobacco and cigarettes may limit (due to the insignificant difference in prices for legal cigarettes and HTPs) the growth of the illicit cigarette market. Heated tobacco consumption, the market of which is **completely legal**[74], is a better alternative for the budget compared to the

[73] State Service of Ukraine letter from 28.07.2025 № 18610/7/99-00-21-03-03-07. URL: https://tax.gov.ua/zakonodavstvo/podatkove-zakonodavstvo/listi-dps/79630.html

[74] The excise policy and illicit trade in tobacco products: in search of balanced solutions. Koshchuk T., Pasichnyi M. / edited by T. Koshchuk, T. Кощук, Growford Institute, Kyiv: 2024. URL: https://www.growford.org.ua/research/aktsyzna-polityka-i-nelegalna-torgivlya-tyutyunovymy-vyrobamy-u-poshu-kah-zbalansovanyh-rishen/

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potential switch to illicit products. The average annual share of the illicit cigarette market in Ukraine in 2024 was 16.1%, in 2025 – 15.9%, which led to tax losses of 21.9 and 26.5 billion hryvnias, respectively. The growth of illicit trade in tobacco products provides benefits exclusively to participants in shadow schemes and creates a basis for the spread of organized crime.

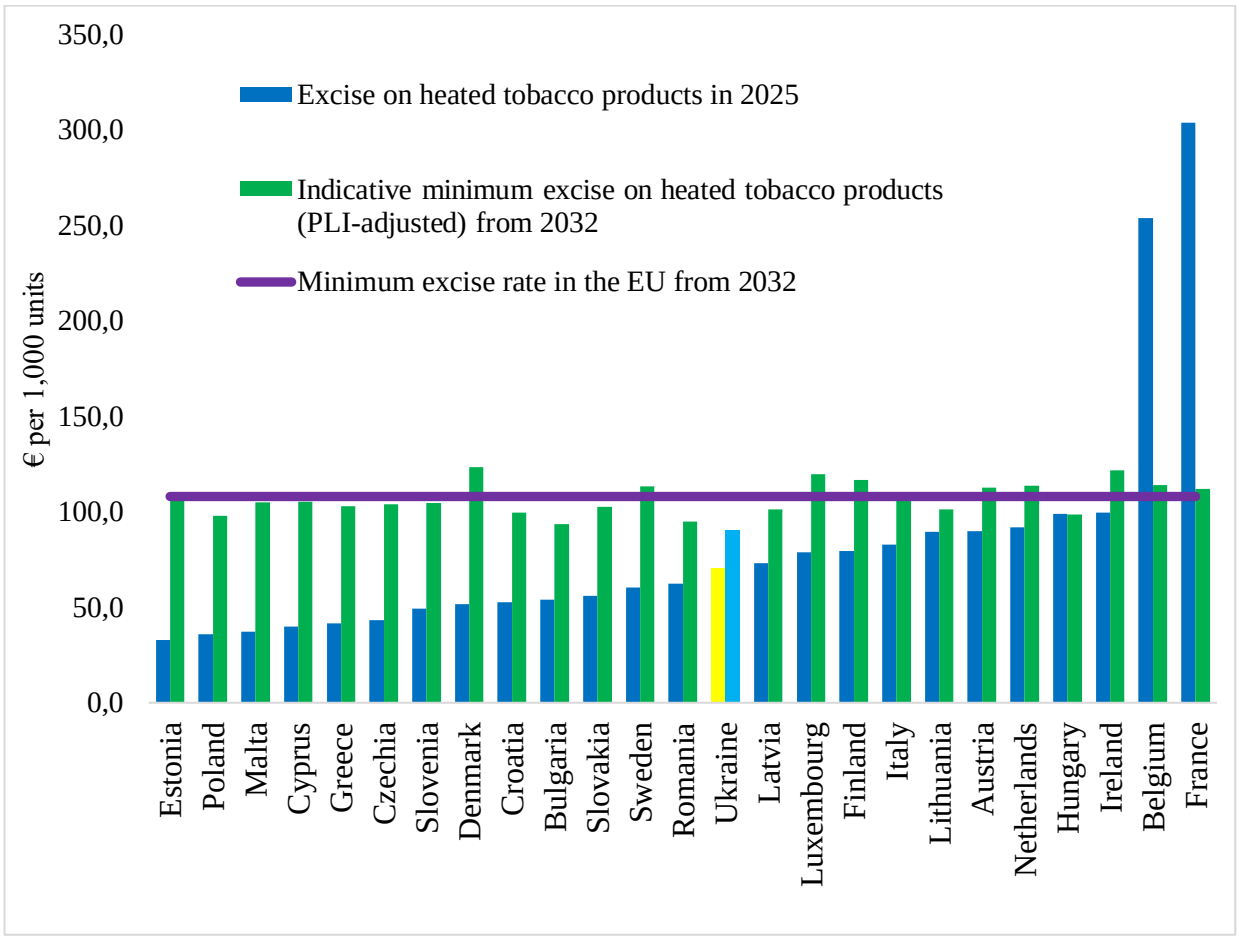
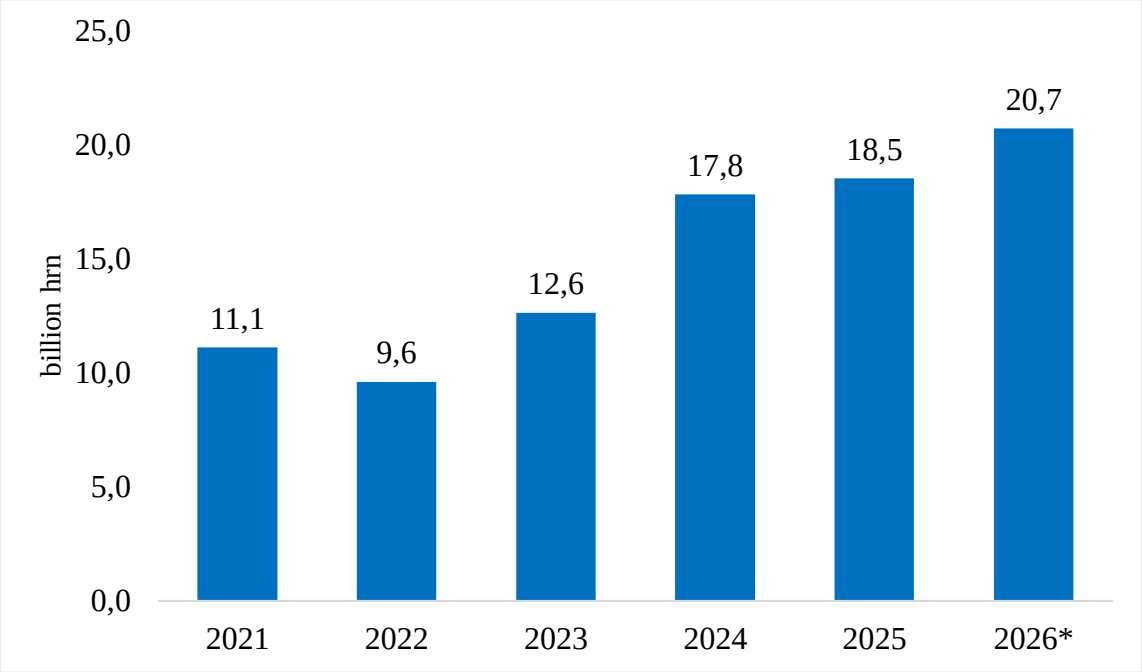


Figure 5.5 Excise duty on heated tobacco products in the EU member states and Ukraine (2025) and EC proposed national minimums in 2032 (PLI 2024 adjusted)

Source: European Commission. Taxes in Europe Database. URL: https://trade.ec.europa.eu/access-to-markets/en/content/excise-duties#toc_3; Price level indices. Eurostat. URL: https://ec.europa.eu/eurostat/data-browser/view/tec00120/default/table?lang=en

The legality of the heated tobacco market, setting rates in euros, and differentiation of the excise duty burden on HTPs and cigarettes had a positive impact on tax revenues. According to our calculations, *in 2025 the budget received **18.5 billion hryvnias** in excise duty from heated tobacco*. It is expected that these revenues will also increase in 2026. The dynamics of excise duty revenues from HTPs in Ukraine is shown in Figure 5.6.



* - forecast data

Figure 5.6 Dynamics of excise duty revenues from heated tobacco products in Ukraine, over 2021-2026

Source: prepared by the authors on the basis of STS of Ukraine data

Estelle Doshi and *Xie Shang*, having conducted a study, have found that the demand for heated tobacco is price elastic (sensitive to price changes). The price elasticity for HTPs ranges from −1.2 to −1.3, which is four times higher than the corresponding indicator for cigarettes (−0.3). It was found that *in case of simultaneous increase in excise rates on heated tobacco and cigarettes, there will be decrease in consumption of heated sticks without consumers switching to cigarettes*[75]. This may be an indirect sign of ***shifting consumer preferences from HTPs to e-cigarettes***.

As noted in the previous sections, ***the level of illicit trade*** of liquids for electronic cigarettes in Ukraine ***is exceeding 90%***, that makes switching to these products highly undesirable.

If effective countermeasures against illicit market of liquids for electronic cigarettes are not provided, as excise duty on heated tobacco and cigarettes increases, vaping may become the choice of both cigarette smokers and HTPs users. This replacement is already occurring, as evidenced by *WHO* data (Table 5.3).

According to the mentioned estimates, *in 2023* shares of electronic cigarettes and HTPs in the structure of consumption of tobacco and nicotine-containing products in Ukraine were almost identical. At the same time, *excise revenues from heated*

[75] Dauchy, E., & Shang, C. (2024). The price elasticity of heated tobacco and cigarette demand: Empirical evaluation across countries. *Health Economics*, *33*(12), 2708-2722.

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sticks (12.6 billion hryvnias) were ***almost 30 times higher*** *compared to the excise paid from e-cigarette liquids* (0.43 billion hryvnias).

Table 5.3

Prevalence of consumption of tobacco and nicotine-containing products in Ukraine in 2023-2024

Product type	2023, %			2024, %		
	Men	Women	Total	Men	Women	Total
cigarettes	37,8	9,3	22,2	28,2	9,2	17,8
e-cigarettes	4,2	2,4	3,3	7,0	3,9	5,3
HTPs	3,4	2,7	3,0	3,3	2,0	2,6

Source: prepared by the authors based on data from: Use of tobacco and nicotine products among adults in Ukraine – results of a sociological survey of adults aged 18 and over. WHO. 2025. URL: https://www.who.int/ukraine/uk/publications/m/item/tobacco-and-nicotine-product-use-among-adults-in-ukraine---findings-from-a-sociological-survey-among-adults-aged-18-years-and-over---comparative-analysis-of-the-2023-and-2024-survey-rounds

In 2024, the use of e-cigarettes was twice as high as that of heated tobacco. However, *the state budget received* ***more than 45 times more*** *excise duty from HTPs* (11.8 billion hryvnias) *than from e-cigarette liquids* (0.26 billion hryvnias).

According to our estimates, ***in 2025*** this ratio was ***37 times***. Considering the number of excise duty stamps sold, about ***0.5 billion hryvnias*** *of the excise duty was received from liquids for electronic cigarettes*. Excise duty revenues from heated tobacco amounted to 18.5 billion hryvnias.

Thus, ***the gap between tax revenues from heated tobacco and e-liquids remains enormous.*** This is clear example of consequences of the parallel operation of fully legal HTPs market and almost completely shadowy vaping market.

In Ukraine, it is important to avoid significant price gap between heated tobacco and liquids for electronic cigarettes. *Illicit market players are interested in creating a price advantage for e-cigarettes.* If the excise duty on HTPs increased in the same way as on cigarettes, there would be a risk that consumers of cigarettes and heated sticks would more often choose illicit vapes as an alternative. This would lead to an additional decrease in sales of legal tobacco and nicotine-containing products. Everyone would lose from such a short-sighted excise policy – consumers, the budget and representatives of the industry, which are among the largest taxpayers in Ukraine[76].

Taking into account the practice of EU countries, the norms of the Proposal, and Ukrainian experience in differentiation of excise duty rates on heated tobacco and cigarettes when justifying the guidelines of our state's tax policy for the future

[76] TOP 100 private taxpayers 2025: ranking. URL: https://delo.ua/business/top-100-privatnix-platnikiv-podatkiv-2025-reiting-453225/#google_vignette

will increase the fiscal significance of the excise duty and the effectiveness of combating illicit markets for tobacco and nicotine-containing products.

Nicotine pouches are less popular than e-cigarettes and heated tobacco. According to the survey made by *the Kyiv International Institute of Sociology*, in February-March 2025, 1% of the adult population of Ukraine used them[77].

The Commissioner *Wopke Hoekstra* said that the Proposal introduces EU requirements for taxation of novel products, including nicotine pouches. *Mandatory excise duty application is fundamental* as it will lead to higher prices and therefore less availability of these products. Nicotine pouches are currently relatively inexpensive in the EU[78]. In addition, it is important to remember that excessive tax burdens and strict prohibitions can undermine efforts to achieve health objectives, create trade barriers and lead to the development of illicit markets for excisable goods.

From September 1, 2024, *in Ukraine*, excise duty is levied on import and sale in the customs territory of Ukraine of goods falling under the UKT FEA (Ukrainian Classification of Goods for Foreign Economic Activity) code 2404 91 90 00 – "Other nicotine-containing products for oral use". In 2026, the excise duty rate for these products, which *are nicotine pouches, is set at rate of 77 euros per kg. In 2028, this rate will increase to 85 euros per kg.* ***According to the Proposal, from 2032, the tax rate for nicotine pouches for Ukraine, taking into account adjustment on PLI, could potentially be 120 euros per kg*** (the base rate is 143 euros per kg).

As for **cigars**, also considering the upcoming European taxation rules initiated by the European Commission, *Ukraine may be forced to increase the excise duty from 85* ***to 120 euros per kg (by 35 euros)*** *during 2029-2032*. Such a rate of increase will be a challenge.

Cigarillos in Ukraine *are taxed at the minimum excise duty of 82 euros per thousand units starting from January 1, 2026*, which corresponds to the level of taxation of cigarettes. In *2028*, this excise duty will increase to *90 euros per thousand units*. Despite the fact that ***the requirements of the Proposal allow our state to set a tax rate of 120 euros per thousand units for cigarillos from 2032***, it will be possible, based on the experience of a number of EU countries, which is described in Section 1, to continue to tax such products in the same way as cigarettes. *Ukraine will have room for maneuver in choosing the future approach as for cigarillos taxation.*

Thus, Ukraine today ***meets*** *the requirements proposed by the European Commission regarding new minimum excise duty rates in the EU on* ***liquids for electronic cigarettes and is close to achieving*** *the relevant standards for* ***heated tobacco in***

[77] Use of tobacco and nicotine-containing products: February-March 2025. KIIS. Analytical report. URL: https://center-life.org/wp-content/uploads/2025/05/Zvit-Spozhyvannia-tiutiunovykh-ta-nikotynovykh-vyrobiv-v-Ukrai-ni-2025.pdf

[78] EU Commission faces rising pressure to tax vapes and nicotine pouches URL: https://www.euronews.com/my-europe/2025/06/02/eu-commission-faces-rising-pressure-to-tax-vapes-and-nicotine-pouches

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2032. ***It will be more difficult*** *for our country* ***to comply with the new*** *European taxation* ***rules*** *in the field of* ***nicotine pouches, cigars and cigarillos***. At the same time, it is quite likely that, because of the ongoing discussions around the Proposal, a number of its provisions will be softened, and Ukraine will demonstrate greater readiness to implement them.

We believe that ***the best strategy for Ukraine will be compliance with the current schedule for increasing the excise duty rates on tobacco and nicotine-containing products for 2025-2028, and further changes as for the excise policy of our state should be initiated after the adoption of the final version of updated EU directive in this area.***

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