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Introducing Specific Taxation on Tobacco Products to Protect Public Health

1. Background

Raising taxes on tobacco is the most cost-effective measure for reducing tobacco use. Evidence shows that a well-administered tobacco tax leads to the desired result of reducing consumption, particularly among youth and the poor. They also reduce the health and economic devastation caused by tobacco. At the same time, raising tobacco taxes can bring in new revenues to finance health and development efforts.

Though taxation is the most efficient and cost-effective way of tobacco control, Bangladesh could not achieve the expected results for its faulty taxation system. Due to the complex multi-tiered ad-valorem tax structure, cigarettes are remaining cheap and affordable. As a result, smokers are switching to cheaper cigarettes instead of quitting. Variation in the type of tobacco product (cigarettes, biris, and smokeless tobacco) has made the situation more challenging. Low taxes and prices of biris and smokeless tobacco keep these products highly affordable. Moreover, the ad-valorem tobacco tax structure is the cause of unexpected profit growth in the tobacco industry. To address the above problems, experts and tobacco control activists have been demanding to introduce a Specific Tax on tobacco products for many years. However, there is limited evidence on and capacity for the process of implementation of the specific tax, possible challenges, and mitigation strategies.

2. Current Tobacco Tax Structure in Bangladesh

Bangladesh has a complex multi-tiered ad-valorem excise tax system for tobacco products. In the ad-valorem method, tax is levied as a percentage of the value (e.g., retail price, or the producer/ex-factory price). Three categories of taxes: supplementary duty as a proportion of maximum retail price (MRP), Value Added Tax (VAT), and Health Development Surcharge are imposed on cigarettes, biri, zarda, and gul.

Tax on cigarettes: There are four tiers of cigarettes - premium, high, medium, and low tier – with variations in the retail prices of the four tiers. The complicated tiered ad valorem cigarette tax structure, with a low base price for each tier, has made tobacco tax a less effective instrument to control tobacco use and created an opportunity for manufacturers to avoid taxes.

3. About Specific Tax

Specific excise tax is a set monetary amount levied on a unit of tobacco products – e.g., per single cigarette; a pack of 10 cigarettes; a box of 1,000 pieces; and/or a particular weight (e.g., net weight in kilograms, as is the case for most smokeless or smoking tobacco products).

Regardless of all these effects of taxes on prices and tobacco use behavior, it is clear that ad valorem excise tax revenue depends on the industry's pricing strategy. If ad valorem taxes go up, the industry can lower the base price and reduce the revenue collected by the government. In contrast, specific excise tax revenues per pack are relatively independent of changes in industry price. A tax system that is independent of the manufacturers' pricing strategy increases the stability of tax revenue. This also results in specific tax system revenues being more predictable. Since specific duties are independent of changes in price, they generally produce a more stable stream of revenue.

Globally, 66 countries are practicing specific only excise taxation systems. Of them 19 are from higher-income countries, 19 from upper-middle income, 21 from lower-middle-income, and 7 from lower-income countries. A mixture of both specific and ad valorem excises tax is being applied by 61 countries, 29 of them from higher-income countries, 19 from upper-middle income, 11 from lower-middle-income, and 2 from lower-income countries (WHO Report on the Global Tobacco Epidemic, 2019).

Differences between Specific and Ad-valorem tax

Specific tax	Ad-valorem tax
Specific excise is a set monetary amount levied on a unit (a stick of a pack or a box) of tobacco products and/or a particular weight (per gram or KG)	Ad valorem excise is levied as a percentage of a price point in the supply chain, for example, the factory price or the retail price
Effective in reducing tobacco consumption and smoking prevalence, especially among the youth	Less effective
Improve public health outcomes	Contribution is less than expected
Generate relatively more government revenue	Generate less government revenue
Easy to determine the amount of the tax	Difficult to determine the amount of the tax
Raises all product prices	Do not raise all product prices equally
Be administratively simple	Complex to administer
Relatively independent of changes in industry price. Hence, not subject to industry price manipulation	Tax revenue depends on the industry's pricing strategy. Hence, subject to easy manipulate
Revenues being more predictable, generally produce a more stable stream of revenue	Revenues being less predictable
Does not automatically adjust with inflation	Automatically adjust with inflation
Requires monitoring the volume of sales	Requires monitoring the value

4. Implementation of Specific Taxation

Determining tax base

Specific taxes are much easier to administer from a budget point of view because they only require determining and verifying the number of tobacco products sold or produced, depending on the country, or simply counting the number of tax stamps.

Inflation adjustment

Under specific tax systems, the specific tax would need to be increased on a regular basis to maintain its real value. While many countries do this manually, some countries (e.g., Chile) have automatic adjustments to specific taxes to maintain their real value.

Compliance-enhancing procedures

A specific tax requires monitoring the volume of sales. Evidence suggests that when systems of record-keeping are rudimentary, the physical volume may be easier to check, and specific taxation to that extent preferable. Monitoring domestic production and trade activities by conducting physical controls and requiring tax stamps are crucial. The costs of physical control increase when the potential for fraud by excise officers is considered. However, evidence shows that fraud is reduced considerably when excise officers are rotated frequently among different locations and when supervisors conduct supervision visits. Digital tax stamps provide an effective tracking and tracing system to reduce tax evasion. Digital tax systems carry information concerning the brand and manufacturers' name, the facility where the products were produced, and the time the stamp was produced and purchased. The product can thus be traced back to its source. Banderoles and digital tax stamps differ in that the finance ministry obtains the necessary information live from the banderole system, whereas the digital system requires distributors to place an order via a secure connection to a designated government authority. After the authority verifies and approves the order, the distributor fulfills the order by delivering encrypted codes and authorizing digital stamps. However, it is important to identify how the authority verifies the order. For instance, the cigarette distributor prints the digital stamps, and the cigarettes are then shipped to retail outlets.

5. Specific Taxation: Country Experiences

Philippines

Having gained expertise from its prior experience with ad valorem, specific, and mixed systems, the Philippines undertook tax reforms that eliminated its previous four-tiered specific system in favor of a uniform specific tax. The Sin Tax Reform Act (STL), which was passed in the Philippines in 2012, gradually increased the specific excise tax on tobacco from PHP 2.72 for low- and medium-priced brands and PHP 12 for premium brands over time to a uniform tax of PHP 30 in 2017. Due to this reform, by 2017, the average price per pack had more than doubled.

Between 2012 and 2015, domestic cigarette sales fell from 5.79 billion packs to 4.16 billion packs, a 28.1% decline as a result of all these measures. Total sales (imports plus domestic) fell from 12.18 billion packs in the first two years to 8.22 billion packs in 2014 before rising to 8.86 billion packs in 2015 as a result of the nation's economic expansion. Adults' current tobacco use reduced dramatically from 28.3% to 22.7% between 2009 and 2015 (a drop of 1.5 million smokers), and among men, it dropped from 47.7% to 40.3% (about 545 thousand fewer smokers among males). The percentage of adult females who smoke has virtually halved, dropping from 10.1% to 5.8% (about 956 thousand fewer females). Although there hasn't been a recent comparative study on the prevalence of smoking among students, surveys of adults reveal that the decrease in smoking was even higher among young adults (18 to 24 years old), declining by one-third from 35% to 22% between 2012 and 2015.

Malaysia

All tobacco and tobacco-related items are subject to excise taxes and import duties in Malaysia. Earlier, tobacco and tobacco products were subject to a weight-based tax. However, starting in 2005, the country introduced a specific tax per stick where the number of sticks was used to determine all cigarette duties and taxes as it simply calls for counting the sticks rather than weighing them which is much easier. In 2015, Malaysia's tobacco tax policy saw significant changes, including a 42.8% rise in the cigarette excise rate and the implementation of the GST. The government introduced the Goods and Services Tax (GST) in April 2015. Later, in September 2018, the GST was replaced by the Sales and Services Tax (SST), which added a 10% tax on tobacco items. Tobacco items sold in tax or duty-free shops in Malaysia are also subject to excise taxes.

Malaysia has devised and put into place measures and systems of production and storage warehouses to enable excise regulations on tobacco products. Excise taxes are levied by the government at the point of manufacture and importation, and the tax payments must be made at fixed intervals. In addition to tax measures, Malaysia also has some licensing protocols to regulate the tobacco industry. It has a license or equivalent approval or control system for the manufacture of tobacco products and manufacturing equipment; import or export of tobacco products and manufacturing equipment; growing of tobacco, except for traditional small-scale growers, farmers, and producers; and wholesaling, brokering, warehousing or distribution of tobacco and tobacco products or manufacturing equipment.

Sri Lanka

Every cigarette produced in Sri Lanka is subject to a specific tax to be paid. The specific tax structure is divided into 5 tiers of cigarettes depending on the length of the cigarette. The tax rate is established by the minister of finance, and the order is published in a Gazette. The industry is responsible for paying the tobacco tax, which is calculated based on the volume of cigarettes produced and removed from the manufacturing facility. This means that the entire amount of tax due is determined by the overall number of cigarettes that are withdrawn from a manufacturing factory. According to the tobacco tax act, each individual that conducts business as a manufacturer of cigarettes or pipe tobacco using Sri Lankan tobacco leaf is obligated to pay the tobacco tax. The act also mandates that all tobacco manufacturers within the country need to be registered by the Excise Commissioner.

Sri Lanka. Excise rates were raised in October 2016 by 26–28% for two higher tiers, by 37–40% for two medium tiers, and by 67–% for the lowest tier. After that, on November 1, 2016, the VAT rate was raised to 15%, and cigarettes were once again subject to VAT and NBT. This caused the prices of cigarettes to go up rapidly. Due to the tax change, the price of the John Player Gold Life brand jumped from LKR 32 to LKR 55 (171.88%). Apart from these taxes, the tobacco industry is also required to pay a 40% corporate income tax. Additionally, the Sri Lankan government taxes imported cigarettes by 85%. With taxes equaling 77% of the price of the most popular brand, Sri Lanka currently achieves the highest level of cigarette taxation prescribed by the World Health Organization (WHO). The country has been lauded by the WHO for this accomplishment.

Singapore

Singapore has one of the strictest tobacco control environments in South-East Asia. The country has seen an increase in tobacco tax revenue over the past ten years. A large portion of this is attributable to Singapore having one of the highest cigarette tax rates in this region. Singapore reviews and adjusts tobacco tax periodically according to a set process or system.

From July 2003, Singapore began taxing cigarettes on a per stick basis, increasing the levy from SGD255 per kilogram to SGD0.255 per stick (of 1g) and a 10% tax hike. Singapore implemented a stick-based or unit-based tobacco taxation scheme to combat the rise of cheap cigarettes with lower tobacco content and weight that were more accessible to current smokers and prospective young new smokers.