

HM Treasury Consultation: Tax Treatment of Heated Tobacco Products

Introduction

This is a joint submission from Action on Smoking and Health (ASH) and the UK Centre for Tobacco & Alcohol Studies (UKCTAS). ASH is a public health charity set up by the Royal College of Physicians in 1971 to advocate for policy measures to reduce the harm caused by tobacco. ASH receives funding for its full programme of work from the British Heart Foundation and Cancer Research UK. It has also received project funding from the Department of Health to support tobacco control. The UK Centre for Tobacco & Alcohol Studies (UKCTAS) was created in 2008 and includes research teams in twelve UK universities. It is one of six Public Health Research Centres of Excellence, funded by the UK Clinical Research Collaboration. Neither ASH nor UKCTAS have any direct or indirect links to, or receive funding from, the tobacco industry.

General Observations

Introduction

The major tobacco manufacturers are introducing 'heat not burn' (HNB) tobacco products into the global market, which are heated tobacco products that produce vapour rather than smoke. These are tobacco products and should be taxed as such. However, they are neither smoked nor smokeless products and therefore it is appropriate for a new category to be established. More work is needed before we fully understand the health impacts of these products and that should be a key factor in deciding how they should be taxed. The market share of HNB products is at the moment very small, and will take time to develop. However, the decision by HM Treasury to consult on tax treatment at this early stage in the evolution of the market is sensible as it should ensure that an appropriate tax structure can be put in place before they become well established. We also agree with HMT that introducing a new category would give certainty to consumers and producers about the duty heated tobacco products are liable for, reduce complexity in the duty system, and ensure that products are captured efficiently.

Tax policy and behaviour change

Tobacco taxation has been at the heart of UK government policy to improve the health of the nation by driving down smoking prevalence for over 20 years. A tobacco tax escalator to reduce the affordability of tobacco was first introduced under a Conservative government in 1993, on the understanding that this *"is the most effective way to reduce smoking"*,¹ a conclusion which is supported by the evidence.^{2 3 4 5 6} The UK government supports a harm reduction strategy which encourages smokers who can't quit to switch to less harmful nicotine products.⁷ There is already a precedent in government tax policy being used to encourage smokers to switch to less harmful nicotine products. In 2007 it was decided to reduce the VAT on nicotine replacement therapy bought over the counter from the standard rate to the minimum allowable of 5%, to encourage smokers to quit using NRT.⁸

We support the decision by HMT not to include electronic cigarettes in the consultation, not only because, as the consultation document states, electronic cigarettes do not contain tobacco and therefore are not liable for tobacco duty, but also because they are significantly

less harmful than smoking, and therefore smokers should be encouraged to switch.^{9 10} A study published in 2017, and based on 2014 data, found that in almost every country sampled apart from the UK, it costs a smoker more to switch to using electronic cigarettes than it does for them to continue smoking. Only in the UK was the cost of a rechargeable e-cigarette lower than the weighted average price of a pack of combustible cigarettes, although once the device has been bought the price of e-liquid is cheaper than combustible cigarettes in most jurisdictions.¹¹ Saving money is one of the top three reasons smokers give to ASH for using e-cigarettes (they can provide more than one answer and the other major reasons are as an aid to quitting smoking completely or to prevent relapse).¹² Not only should excise tax not be levied on e-cigarettes or e-liquid, but in addition any medicinally licensed products should have VAT levied at only 5%, as for traditional NRT, to increase the price incentive to switch.

However, it should be noted that some EU member states have started to levy excise taxes on e-cigarette liquids, or are considering doing so. The EU consultation on the review of the Tobacco Tax Directive has asked for respondents' opinions on whether electronic cigarettes should be included in the Directive. We urge the UK government, which is still involved in the development of the Directive, to explain why for public health reasons this is not the right approach.

Relative risk of heat not burn products and implications for tax policy

We consider it a plausible hypothesis that such products will eventually be shown to be substantially less harmful than smoked tobacco, because so much of the harm caused by smoking is a result of the by-products of tobacco combustion. However, we do not consider the existing published evidence produced by the tobacco industry to be sufficient for a definitive conclusion on this point. It is also possible that the harm caused by heated tobacco products may vary according to factors such as the quality of design and manufacturer of heating devices (for example because they may cause some proportion of the tobacco used to be inadvertently burnt), and from differences in the way that consumers use the product.

Therefore, we take the view that tobacco control policy in relation to heated tobacco products should reflect objective evidence on harm and benefits. Since this not yet robust, tax policy in relation to such products should allow flexibility over future levels of tax, and the possibility should exist for these levels to reflect relative levels of harm as against other tobacco products. We therefore support HM Treasury's proposal that a separate tax category for such products should be created in the Tobacco Products Duty Act. We welcome the commitment in section 3.6 of the consultation document to share evidence related to health impacts with the Department of Health.

Because of the long record of tobacco industry manipulation and deceit over scientific and medical evidence, and because of the consequent obligations on the UK Government under Article 5.3 of the WHO Framework Convention on tobacco control, which precludes the engagement of the tobacco industry in setting public health policy, we consider that the UK Government will need expert advice on the emerging evidence on heat not burn and other novel tobacco products. The UK Government has asked the independent Committee on Toxicity to look at the data on toxicity for these products submitted to them by the manufacturers prior to their entry into the UK market, as required by the Tobacco and Related Products Regulations 2016 (SI 2016); this is welcome but not sufficient.

Consideration should therefore be given to establishing a suitable committee to examine not just the toxicity but also the broader health and related social impacts of such products. The terms of reference should include not just an assessment of the appropriate tax treatment for these products, but also the broader regulatory framework.

We note, however, that making an assessment of the health and related social impacts of such products will not be simple, since it should include consideration of at least the following factors:

- How many smokers will switch from smoking to such products?
- For those users who do switch from smoking to such products, over the long term what is the reduction in risk?
- How difficult will it be for users of these products to quit their use altogether? (In other words, what is the dependency rate of these products compared to cigarettes and existing alternative nicotine products?)
- Will these products lead to substitution for existing Nicotine Replacement Therapy products (NRT), or e-cigarettes, and what if any will be the increase in risk or benefits for users who would otherwise have used NRT or e-cigarettes?
- What proportion of users of these products have never smoked, and what proportion would never have smoked even if these products did not exist? What is the consequent increase in risk for these users?
- What is the emerging evidence of harm (if any) from the use of reduced risk products?

Answers to Specific Questions

Question 1: Is introducing a new category in the Tobacco Products Duty Act 1979 the best way to capture heated tobacco products for duty purposes? If not, how should heated tobacco products be captured?

For the reasons stated above, we support this proposal and do not think there is a more desirable alternative.

Question 2: Are you aware of any current, or planned, heated tobacco products which would not fit into these categories?

The category definitions set out in the consultation document are:

- processed tobacco heated directly to produce vapour
- processed tobacco designed to be heated in a vaporiser
- devices that produce vapour from non-tobacco sources, where the vapour is then passed over processed tobacco in order to flavour the vapour

We are not aware of any additional categories. In all three cases it is a plausible hypothesis that such products will eventually be shown to be substantially less harmful than smoked

tobacco, because so much of the harm caused by smoking is a result of the by-products of tobacco combustion.

There are already multi-purpose vaporisers for sale on the UK market that can include chambers for heating dry leaf. Any tobacco used in such devices would probably be hand-rolled, pipe or from factory made cigarettes and therefore would currently be captured under existing tobacco tax categories.¹³

Question 3: Do these criteria accurately define and capture both current and planned heated tobacco products? Are there any criteria which should not be included in a definition?

In the consultation, HMT proposes that a definition of heated tobacco for duty purposes should be based around the following criteria:

1. is not cigarettes, cigars, hand-rolling tobacco, or chewing tobacco
2. consists of or includes tobacco
3. has been prepared to produce or flavour vapour
4. has not been prepared for use in a water pipe

The proposed criteria are appropriate, but see answer to question 2 above.

Question 4: Are there any products other than heated tobacco products that could be captured by this definition?

The definition will also need to include a characteristic that differentiates heated tobacco from HRT, in case the tobacco would otherwise meet the HRT definition. Current products do not seem to have objective criteria through which heated tobacco could be differentiated. Therefore, the government is minded to include criteria based on the fact that the heated tobacco is encased, for example in a capsule. A maximum size for capsules could then be set to ensure that it captured products specifically designed for use in heated tobacco devices.

We are not aware of any products other than heated tobacco products which could be captured by this definition.

Question 5: What would be an appropriate maximum size for a heated tobacco capsule? Would it be appropriate for the maximum size to be based on the weight of the tobacco?

We have no view on maximum size, but basing it on tobacco weight seems appropriate given that this is the proposed basis for setting tax levels in this category. For HNB products, tobacco weight is lower due to the method of delivery (e.g. IQOS 'HEETS' contain around 50% tobacco of conventional cigarettes) and furthermore the same weight of tobacco burnt versus heated is likely to produce greater health risks. These factors need to be taken into account when setting the tax to be levied per quantity of HNB tobacco. The issues are complex and the Government needs to be informed by the best scientific and technical

advice, provided by independent experts and not directly by the tobacco industry, in line with our commitments as a Party to the WHO FCTC (Article 5.3). This is why, as set out above in our general observations, we consider the formation of an expert committee to be appropriate.

Question 6: Alternatively, are there any objective, technical or scientific criteria that differentiate heated tobacco from conventional tobacco for smoking?

Not in addition to those set out in the consultation document.

Question 7: Are there any other criteria that the government should consider including in the definition?

Not as far as we are aware.

Question 8: Are there any consumer or product-based incentives for manufacturers to develop products outside of these categories?

In mature and highly regulated markets, there is a strong incentive for tobacco manufacturers to develop reduced harm products (if scientifically and technically possible), since this may enable them to maintain market share as the number of conventional smokers continues to decline. The manufacturers are already involved in the electronic cigarette market, and as stated above we support the decision not to include electronic cigarettes in this consultation. It is possible that the manufacturers might produce novel non-heated tobacco products, which could sit within a category 'smokeless tobacco', but at the current time there are no such products on the market that we are aware of.

Question 9: Would a smokeless tobacco category be a better way to capture heated tobacco products? If so, how should smokeless be defined?

No, a smokeless tobacco category would not be a better way to capture heated tobacco products. Smokeless tobacco products are chewed, sucked or sniffed to achieve nicotine absorption from the oral or nasal mucosa. Heated tobacco products are designed to produce a vapour which is inhaled to allow nicotine absorption from the lungs. The latter inevitably exposes the delicate airway and alveolar structures of the lung to heat and the constituents of the vapour, which potentially include toxins and oxidants, potentially causing airway inflammation and narrowing, emphysema, fibrosis and cancer. Smokeless products are not inhaled and hence carry none of these lung-specific risks.

Question 10: Are there any wider implications of introducing a smokeless tobacco category which the government should consider, for instance on other types of tobacco?

Currently the UK treats different types of smokeless tobacco very differently. There is a tax category for chewing tobacco, but not for oral snuff as it is prohibited in the UK and is not

therefore liable to tax; nor is there a tax category for nasal snuff, which while it is legal is not subject to excise tax.¹⁴

Question 11: Do you agree that a heated tobacco duty category should only capture the tobacco capsule used in devices, rather than devices themselves?

As the consultation points out this is consistent with the treatment of pipe tobacco which is liable for tax while smoking pipes are not.

In addition this seems a sensible approach given the high upfront cost of a device compared to cigarettes, which do not require a device and for which the price of entry is set by the cost of the minimum pack size (from 20 May this is now a minimum pack size of 20 cigarettes or 30g of handrolling tobacco). The cheapest factory-made cigarettes on sale in a well-known high street supermarket are Chesterfield at £6.49, while 30 grams of the lowest priced handrolled tobacco (Pall Mall) can be bought for £9.76 a pack.¹⁵ Although this is more expensive than the cheapest factory made pack of 20, given the average size of a roll your own cigarette in the UK is 0.5 grams the price per stick is considerably lower at 16 pence per stick as compared to 32 pence, or double the price, for the cheapest factory made alternative.¹⁶

In comparison, at launch the IQOS device retailed at £45, with a pack of HEETS costing £8, the equivalent of 40 pence per stick.¹⁷ The online IQOS catalogue lists a starter kit – with IQOS holder, charger and five packs of HEETS - at £82.50 (rather confusingly the standard price for the kit without five packs of HEETS is £89).¹⁸ The IQOS holder and pocket charger are guaranteed for one year, or 7,300 cycles (equivalent to 20 a day for 365 days)¹⁸, and the cost of a replacement IQOS holder is £49.¹⁸

The high cost of purchasing the device makes it less affordable in particular for poorer smokers, and is a disincentive to switch, so it would not seem sensible to exacerbate this by further increasing the price by adding excise tax.

Question 12: Do you agree that weight is the best way to calculate the duty on heated tobacco?

Yes (but see answer to Q 5 above).

Question 13: If the duty on heated tobacco is levied based on weight, how should the duty be calculated; the weight of the total capsule, the weight of the capsule contents, or the weight of the tobacco?

It would be simplest and most appropriate to tax the weight of tobacco, since some devices might conceivably use capsules that contain some other products in addition to tobacco.

Question 14: Are there any other factors that the government should consider in deciding the regime for calculating the duty on heated tobacco products?

Not as far as we are aware.

Question 15: Would there be any difficulties administering the regime in this way?

Not as far as we are aware.

Question 16: Are there any other administrative issues which the government should consider?

Tobacco used in heat not burn devices should be subject to the tracking and tracing regime required under Articles 15 and 16 of the revised EU Tobacco Products Directive (use of unique identifier and security feature), and under Article 8 of the Illicit Trade Protocol, which the UK has committed to ratify.

Question 17: Are there any other factors which the government should consider when setting the duty rate?

As stated in the general observations above we consider that the duty rate should be set at a level that reflects evidence of relative harm (in the broadest sense to include dependence liability in combination with toxicity) compared to other tobacco products and non-tobacco nicotine products. To do this effectively, the Government needs to be informed by the best scientific and technical advice, provided by independent experts and not directly by the tobacco industry. This is why we consider the formation of an expert committee to be appropriate.

Question 18: Thinking about the UK in particular, what is the current size of the market for heated tobacco products (in terms of units sold and amount of tobacco per unit)? How do you expect this will develop over time?

Question 19: For products not currently on sale in the UK, do you have any data on sales or market shares for international sales? How has this changed over time, and how do you expect it to change in the future?

Question 20: Do you have any information on the users of heated tobacco products, particularly compared to conventional tobacco users?

We have answered these three questions together.

The first HNB product on the UK market was JTI's Ploom which was launched in the UK in 2014, without much success,¹⁹ and JTI has developed a new version called Ploom Tech which is available in Japan but not yet in the UK. PMI began selling its version, IQOS, in the UK at the end of November 2016, initially through one outlet in Wardour Street in London, with longer-term plans for nationwide distribution.²⁰ IQOS already has substantial, and rapidly growing, sales in Japan estimated most recently at 5.5% of the cigarette market, but Japan has a very different market environment from the UK and other European countries, for example e-cigarettes are heavily regulated, and it has not for example been as

successful in Italy, the first European country it was launched in.^{21 22} BAT has launched similar products²³ to IQOS (Glo in Japan in November 2016; and iFuse in Romania in 2015), but not yet in the UK. Imperial Tobacco has an electronic cigarette portfolio but has told investment analysts that it will only consider moving in to the HNB market if it replicates its success in Japan in Europe. There are already other devices in the UK market that can vapourise tobacco leaf, which are not produced by the tobacco transnationals, but they do not appear to be widely used.²⁴

At the current time knowledge and usage of HNB products in the UK is low, which is unsurprising as they are so new to the market. ASH commissions an annual survey of attitudes and behaviour on tobacco-related issues. This year for the first time we asked about 'heat not burn' products. The survey was carried out online by YouGov for ASH; the total sample size was 12696 adults. Fieldwork was undertaken between 16th February 2017 and 19th March 2017. The figures have been weighted and are representative of all GB adults (aged 18+). The sample was split in half, with half asked about awareness of 'heat not burn' as a category, and the other half given Ploom and IQOS as examples of the category. Only 11% in our sample had heard of 'heat not burn' as a generic category and the proportion aware of Ploom and/or IQOS as types of 'heat not burn products' was lower at 8%.

The Smoking Toolkit Study (STS), which is a monthly survey of a nationally representative sample of adults aged 16+ that is designed to provide information about smoking prevalence and behaviour, has recently started asking questions about usage of HNB products. At the current time STS has also found very low usage (<1% of past year smokers). As usage grows and the market develops the STS will be a useful tool for monitoring its evolution. Each monthly wave involves a new sample of approximately 1800 respondents, and detailed questions are asked of the approximately 500 respondents who report having smoked in the past year ('last-year smokers').²⁵

The market niche for HNB is likely to be mainly smokers who wish to cut down or quit, or recent ex-smokers who cannot (or do not want to) quit using nicotine, but do not perceive use of electronic cigarettes or other non-nicotine tobacco products as a satisfactory alternative to smoking. We know of no evidence at this point that these products are used to any significant extent by people who have never smoked or that they are a gateway into subsequent smoking behaviour.

The small proportion of respondents who report using heat not burn tobacco products means it is not possible to draw any conclusions on who the users are. However, given the price of the device currently on the market, IQOS, and that the tobacco inserts (HEETS) cost a similar price to mid-range cigarette prices and are much more expensive per stick than handrolled tobacco, it is reasonable to conclude that use is likely to be at higher levels among more affluent consumers. The cost of HEETS is comparable with Sterling, the leading UK brand in 2016 (which currently retails at around £8 a pack of 20) and cheaper than Marlboro Red (around £10).²⁶

The history of how the e-cigarette market developed is relevant, and it seems quite likely that the market for HNB will evolve in a similar way to that of e-cigarettes in the UK. E-cigarettes only became available on sale in the UK around 2006/7^{27 28}, and were initially very

expensive (£79 for the SuperSmoker device, launched in 2007, plus £7.95 for a pack of 6 refills). Rapid growth only really started after 2010 by which time more than 5% of smokers had tried e-cigarettes.¹²

Initially e-cigarettes were not heavily marketed in the UK as they were being sold by small manufacturers and importers, and the money to invest in marketing only became available once sales took off, at which point the tobacco manufacturers began to buy up electronic cigarette companies.

This is a useful comparator as although the tobacco transnationals which are launching HNB products have significant financial resources and distribution networks, the marketing rules on tobacco products prohibit any advertising promotion or sponsorship for HNB, including advertising at point of sale. The industry has therefore to rely on “earned media” for publicity, which is limited. Consumer knowledge is likely to develop through peer groups and social networks, and word of mouth will therefore be the most important marketing tool for HNB, as it was for e-cigarettes, particularly in the early years. We would expect that, absent policy interventions, the number of such products and the number of users in the UK market will both grow, but that market growth in the early years is likely to be slow (as was the case with electronic cigarettes).

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