

## Key market issues

### ANALYSIS OF THE FERMENTED ALCOHOLIC BEVERAGES MARKET

#### **Brief illustration of the problem and effect this problem has on broader functioning of the business/consumers in Ukraine**

Brewing and wine industries of Ukraine are developed sectoral markets that have significant potential for further growth. However, the recent market analysis conducted by BRDO experts revealed that during the last 10 years wine market has decreased by 41%, and beer market by 42%. It is connected with such negative factors as worsening of social and economic situation in the country, decreased purchasing power, and indirect negative effect of the economic slowdown caused by COVID-19 pandemic.

Apart from that, abovementioned markets are restrained from development by 1) overburdening licensing regulations necessary for alcoholic beverages production, including wine, beer, and other fermented beverages; 2) current excise tax policy. As a result, regulatory and tax burden for wine and beer producers is increasing, making their activities unprofitable.

BRDO analysis outlined the following market problems:

- 1) Legally undefined status of “small producers of beer”
- 2) Absence of tax abatement scheme for excise tax payments made by small producers of beer
- 3) Overburdening regulatory, tax, and financial load for producers of wine, beer, and fermented alcoholic beverages derived from honey
- 4) Limited regulatory opportunities for small wine producers to use simplified tax system
- 5) Artificial restrictions for wine market and existence of state prohibitions
- 6) Submission of tax related production information by small producers is cumbersome, non-transparent in form and prone to accounting errors
- 7) Economically unjustified very high monetary penalties are levied against small producers when they submit production declarations with even the smallest errors or by missing arbitrary filing deadlines
- 8) Archaic and inefficient system of paper document flow still in use regarding licensing of production, wholesale and retail trade of alcoholic beverages and excessive costs for receiving paper documents is still borne by enterprises

#### **BRDO regulatory solutions and impact on the stakeholders**

Proposed regulatory changes aim at decreasing regulatory and financial burden for approximately 110 000 enterprises that are active on the market and received license for production, wholesale and retail trade of fermented alcoholic beverages. Proposed changes allow to:

- 1) Ensure harmonization of Ukrainian legislation with the relevant EU regulatory mechanisms
- 2) Stimulate development of SMEs in Ukraine, increase the share of craft beer production (which is 3% as of now, with proposal to increase it up to 10%)
- 3) Improve investment attractiveness of wine and brewing industries as well as production of fermented alcoholic beverages derived from honey
- 4) Simplify doing business regime in alcoholic beverages production and increase in particular the number of small producer business entities on the market of fermented alcoholic beverages.
- 5) Reduce regulatory requirements for opening and operation of business and decrease tax burden with an aim to stimulate production leading to the increase wine, beer, and honey beverages production capacities

on internal market and for export. Proposed changes will allow business to save annually UAH 328.8 mln while simultaneously increase inflow of revenues to the state budget of up to UAH 215 mln in a way of additional excise tax, social and retirement funds taxes, and military tax due as a result of increased employment and augmented production of estimated 20 mln liters of beer in Ukraine.

6) Digitize administrative services on the market

Time and costs of administrative tasks by Regulators (Ministry of Finance of Ukraine, State Fiscal Service of Ukraine, State Service of Ukraine on Food Safety and Consumer Protection) will decrease due to resulting efficiency, speed and transparency of improved regulatory field and bigger reliance on newly introduced e-services.

Proposed regulatory changes on the market of beer:

- Introducing legal definition of the term “small producers of beer”
- Implementation of the EU Council Directive 92/83/EEC that would allow to increase maximum amount of beer production by small producers in Ukraine for up to 200 000 hectoliters per year
- Fully implement the EU Regulation (EC) No 110/2008 of the European Parliament that addresses the issues connected with definition, description, presentation, labelling and the protection of geographical indications of spirit drinks in addition to harmonizing classification of spirit drinks according to the EU standards, ensuring full compliance with the EU rules.
- Differentiation of excise tax rates for beer according to annual amount of production
- Introduction of reduced excise tax rate for small producers of beer that would be decreased by 50% from nationwide rates on beer
- Removal of time limitation for licenses required for alcoholic beverages production (beer)
- Cancellation of mandatory beer producer attestation requirement for production for alcoholic beverages (beer) every 5 years
- Cancellation of necessity to receive separate license for the right of wholesale trade for small producers of beer
- Decrease the cost of license for the right of wholesale trade in alcoholic beverages (beer) for other beer producers
- Decrease the level and number of fines for small beer producers in case of non-submission, untimely submission or submission of report with incorrect information on production volumes and/or sale of alcoholic beverages

Proposed regulatory changes on the market of wine:

- Allow small producers of wine to retain their SME producer status while permitting them to purchase additional grapes to supplement their own wine-making capacity.
- Develop and implement sectoral programmes advancing viticulture and winemaking capacity in Ukraine
- Remove existing prohibition of state support to SMEs that are engage in winemaking and/or sale of alcoholic beverages
- Introduce state support of the sector, that would cover the entire viticultural business cycle.
- Provide implementation in Ukraine of the Regulation 110/2008 and Directive 92/83/EU
- Set up zero rate of excise tax for ordinary (non-sparkling) wine with alcohol content of higher than 1.2% but less than 15%, on condition that ethanol in the final product has fully fermented origin
- Provide opportunity for tax paying small producers of wine, to be placed in the 4<sup>th</sup> group of taxation, provided that they own land lot smaller than 2 hectares and produce wine with their own and purchased grapes. Alternatively, allow small producers of wine to be placed in the 3<sup>rd</sup> group of taxation
- Allow small producers of wine to submit report information about volumes of production and/or sale of alcoholic beverages once a year, instead of once a month
- Decrease economically unjustified very high monetary penalties that are presently levied against small producers when they submit production declarations with even the smallest errors or by missing arbitrary filing deadlines.

- Set up reasonable mechanisms to allow for correction of technical errors during report submission or submission of the report with inaccurate information on production volumes and/or sale of alcoholic beverages that would trigger no penalties or proportional penalty level.

Proposed changes on the market of fermented alcoholic beverages derived from honey:

- Cancel excise stamp for fermented alcoholic beverages derived from honey produced without adding of ethanol and with alcohol content of less than 15%
- Develop and approve state standards for honey-based alcoholic beverages production
- Develop and approve transparent and equitable method of setting excise tax rate for honey based alcoholic beverages that would be based on alcohol content or alternatively by introducing a separate category for “fermented alcoholic beverages derived from honey” in the Tax Code of Ukraine

### **How the BRDO proposed solutions positively affect harmonization of Ukraine’s regulatory environment in a given sphere with best international (EU) practices**

According to the Association Agreement, the tax legislation of Ukraine should be aligned with the EU’s, including in part of excise tax for alcoholic beverages.

Council Directive 92/83/EEC of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages defines that member states could impose lower tax rates (which could differentiate according to the annual volume of production of breweries) for beer produced by small independent breweries, in particular:

- Lower rates are not applied to enterprises that produce over 200 000 hectoliters of beer annually;
- Lower rates which could be lower than minimal rate cannot be lower than 50% of the national excise tax rate.

For the purposes of applying lower rate the Directive also defines the term “small independent brewery”.

BRDO analysis suggests solutions aimed at the implementation of the above-mentioned Directive by raising maximum volumes of beer production for small breweries up to 200 000 hectoliters annually, setting reduced excise tax rate for small breweries by 50% from the nationwide rate on beer, and legal definition of the term “small breweries”.

Apart from that, according to the article 5 of the Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages, the zero-excise tax rate is set for wine. The implementation of this Directive is not anticipated by the Association Agreement. However, part 2 of the article 1 of the mandatory implementation of the Directive 92/83/EEC anticipates that member states must set excise tax rates according to the Directive 92/84/EEC. Therefore, according to the Directive 92/84/EEC, member states can set excise tax rates as 0% or higher.

BRDO analysis suggests solutions aimed at setting the zero-excise tax rate for ordinary (non-sparkling) wines with intensity higher than 1.2% but lower than 15% on condition that ethanol in the final product has fully fermented origin.

Additionally, according to the Annex XXXVIII of the Association Agreement and Action Plan on the Implementation of the Association Agreement Ukraine has committed to implement Regulation (EC) No 110/2008 of the European Parliament and of the Council of 15 January 2008 on the definition, description, presentation, labelling and the protection of geographical indications of spirit drinks and repealing Council Regulation (EEC) No 1576/89, in particular: legally define the term “spirit drink”, harmonization of classification of spirit drinks according to the EU standards, ensuring compliance with the rules on definition, description, presentation, labelling and the protection of geographical indications of spirit drinks, setting a single classification index for spirit drinks categories and general rules regarding it, legal fixation of prohibition of wrappers and foil made of lead.

According to the Regulation 110/2008, “spirit drink” means an alcoholic beverage that has a minimum alcoholic strength of 15 % vol. Depending on its characteristics, all spirit drinks are classified into categories. In order to be



classified in one of the 46 categories of spirit drinks, such drink must possess a set of enumerated qualities. According to the Regulation, beer made from malt, wine from fresh grapes, cider, perry and mead are not classified as spirit drinks, but rather as alcoholic beverages.

As of today, no legislative initiatives in Ukraine aimed at implementation of the Regulation 110/2008 are present. BRDO analysis emphasizes on the necessity of the implementation and differentiation of regulatorily prescribed differentiation between spirits and alcoholic beverage in Ukrainian regulatory system in line with EU model.