

# Excise Duties in Finland in a Historical Perspective

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## 1 Excise Duties as Consumption Taxes

In Finland, “excise duties” denote a certain, distinct group of *consumption taxes*. However, the term is not defined unambiguously in the literature, and problems abound when one begins looking for equivalents in the history of taxation in Finland or in the tax systems of other countries. As used today, the term nevertheless refers quite consistently to taxes that are levied on the basis of particular legislation and, in principle, explicitly called excise taxes in that legislation. In this perspective - the formal concept of excise duties - the excise duties in Finland comprise the excise duty on manufactured tobacco, the excise duty on alcohol and alcoholic beverages, the excise duty on electricity and certain energy sources, and the excise duty on soft drinks. One thing serving to clarify the concept of excise duty in the European Union, of which Finland is a member, is that excise duties fall into the category known as harmonized taxes. Clearly, EC Directives profoundly influence the content of the excise duties levied on certain products.

As excise duties are part of the system of consumption taxation, it is appropriate to discuss their distinctive features and the ways in which they differ from the other taxes in that category. Here, the salient concept to consider is that of a material excise duty; in other words, taxes that share distinctive features can be classified as belonging to the same group.

Consumption taxes are taxes levied on the consumption of goods and services; the taxes can be subdivided into general and selective consumption taxes according to how extensive the group of commodities is to which the tax applies.<sup>1</sup> In terms of this classification, excise duties are *selective taxes*, the tax

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<sup>1</sup> Here, there is no reason to consider the occasional question whether the taxes on commodities used in entrepreneurial activity fall into the category of consumption taxes or whether such taxes are merely taxes on consumption by private households.

base being narrow in that the duties are levied only on certain products, which are specified in considerable detail in the legislation. In this respect, excise duties differ from the typical general consumption tax, value-added tax, the tax base of which is quite broad indeed.

The nature of the tax base in selective consumption taxes is captured well in the Swedish term *punktskatt* (lit. point tax). The Finnish term for excise duty, *valmistevero* (lit. product tax) is thus in principle narrower in scope than *punktskatt*: in Sweden, the latter in principle denotes all selective consumption taxes,<sup>2</sup> whereas in Finland, excise duties constitute merely one category of such taxes. Other selective consumption taxes in Finland include the car tax, the tax on diesel-driven vehicles and the vehicle tax. These taxes, known as road traffic taxes, are the focus of a separate article in this publication by Professor *Esko Linnakangas*.

Although excise duties are taxes to be applied to consumption, those liable to pay the duties are as a rule not the actual consumers of the products (private individuals). In this respect, excise duties constitute *indirect (consumption) taxes*; that is, the party liable to pay tax passes the tax on to the consumer in the price of the goods.<sup>3</sup> In exceptional cases, however, private individuals may be those liable to pay duties. For example, a traveller may become liable to pay excise duty on alcoholic beverages or tobacco products that he or she brings into Finland for personal consumption.

Taxation on consumption may be implemented in various ways.<sup>4</sup> In Finland, the principal technique today in practice is to levy tax directly on the commodity being consumed, i.e., goods or services. Excise duties is an example of this approach. However, duties are levied only on *certain goods*; they do not include taxes on services. The duties are essentially taxes on goods produced as the result of a particular manufacturing process, with this taxation, particularly in domestic production, being crucially connected to the *manufacturing phase*. For a variety of administrative reasons, among others, the liability to pay taxes arises and the tax is as a rule levied later than in the manufacturing phase itself. Nevertheless, the principal party liable to pay tax is the manufacturer of the product. The taxation of goods manufactured abroad and imported to Finland for consumption has to be implemented differently.

## 2 Research on Excise Duties in Finland

Until very recently, there has been little research done in Finland on excise duties. If one looks exclusively at published research, it can be asserted that

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<sup>2</sup> On the other hand, the concept of *punktskatt* in Sweden cannot be considered a wholly unambiguous one. The question is dealt with by Stefan Olsson in his doctoral thesis (*Punktskatter – rättslig reglering i svenskt och europeiskt perspektiv*) in 2001.

<sup>3</sup> The classification of taxes into direct and indirect is not airtight, for it is not always clear who is the final bearer of the tax burden.

<sup>4</sup> For example, a monopoly is one way to implement taxation of consumption. The reasoning in that case is that because the price charged by a public corporation granted monopoly status by law is significantly higher than cost, it constitutes tax-like revenue.

there appeared no monograph dedicated solely to excise duties prior to my dissertation in 1998 (*Leila Juanto*, “Valmisteverotus. Oikeustieteellinen tutkimus valmisteverotuksen asemasta Suomen verojärjestelmässä” [Excise duties. A legal study of the status of excise duties in the Finnish tax system]).<sup>5</sup> The present article is based in part on that work.<sup>6</sup>

With reference to the paucity of research, it must be pointed out that excise duties were one of the foci of a doctoral thesis on environmental taxes, i.e., *Kalle Määttä*: “Environmental Taxes. From an Economic Idea to a Legal Institution” (1997). However, excise duties are not the only option available for guiding environmental policy through taxation; other tax types can be used to this end as well.

The lack of research-based knowledge on excise duties can in fact be seen to a certain extent throughout the Nordic countries. For example, the first doctoral thesis in Law in Sweden dealing with the topic is quite recent, being published in 2001 (*Stefan Olsson*: “Punktskatter – rättslig reglering i svenskt och europeiskt perspektiv.”)

The last few years have seen an increased interest in excise duties, but the research in the field is meagre compared to that dealing with value-added taxation, for example. For that matter, little doctoral-level research has been done in Finland on value-added taxation either,<sup>7</sup> but quite a few textbooks and handbooks are available on the subject. All in all, the quantity of research on consumption taxes is small compared to that on income taxation, but the situation is improving steadily.

While it is clearly impossible to determine with certainty why there has been so little research done on excise duties, some explanations may be sought. For example, it can hardly be claimed that the lack of research reflects a lack of significant economic interests. Quite the contrary, excise duties have long been a significant source of tax income for the state, as will become apparent below. In the draft state budget for 2002, excise duties account for some 4.52 billion euros.

One crucial factor explaining the paucity of research is that for a long time there was little doctoral-level research in the field of tax law. What interest there was naturally focused on income taxation, which is perceived as the heart of the taxation system. In recent years, however, the situation has improved to the point where tax law is one of the fields within Law that has seen the greatest proportional increase in the number of doctoral theses. It is natural that the topics chosen come to include branches of taxation offering superior opportunities to produce so-called new knowledge.

Another factor that may have kept the quantity of research small is that excise duties, as indirect taxes, do not entail the same broad range of taxpayers as

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<sup>5</sup> A number of unpublished master's theses on excise duties had been written previously.

<sup>6</sup> The sources used in the doctoral thesis are not mentioned separately in this article, because the Finnish material has very limited application outside of Finnish-speaking areas.

<sup>7</sup> In 2001, Mikko Pikkujämsä published a thesis entitled *Oikeusperiaatteet ja arvonlisäverotus kiinteistöalalla* [Principles of Law and Value-added Taxation in the Real Estate Sector]. The preceding work - the first to deal with general consumption taxes, i.e., turnover taxation - dates from 1967 (Aleks. Kotkansalo: *Verotusarvo liikevaihtoverotuksessa. Erityisesti Suomen voimassa olevaa oikeutta silmällä pitäen*. [Tax value in turnover taxation with particular reference to current Finnish law].

income tax, for example. The number of parties liable to taxation is very small indeed compared to that in many other forms of taxation. On the other hand, as taxes are passed on to the consumer in the price of goods, the economic impact of excise duties clearly affects very many people. The small number of those liable to pay excise duties is also the reason why the published practice of the Finnish Supreme Administrative Court contains very few cases. This certainly does not constitute particularly fertile ground for the legal dogmatic research tradition that has long prevailed in tax law research in Finland.

It has also been asserted in accounting for the lack of research on excise duties and other selective consumption taxes that the problems in this field of tax legislation are technical in nature rather than matters of principle. Obviously, the object of taxation determines to some extent the type of legislation that must be drafted. In consequence, excise duty legislation comes to contain norms that strike one as technical in nature, and there is no denying that, for example, understanding the account of taxable products in the case of fuel taxes requires more than just a knowledge of the law. This does not, however, mean that excise duty legislation does not entail the same kind of problems of principle in interpretation as income tax does, for example when it comes to liability to pay tax. Claims that the problems of interpretation in excise duty legislation derive from its technical nature may betoken a lack of familiarity with the field rather than an extensive knowledge of it.

The heightened research interest in excise duties seen in recent years can be explained as a result of international developments and the current relevance of the topic. Finland's accession to the European Union has markedly increased the amount of research being done in the country on the Community. Excise duties, which are harmonized taxes, are very much part of this development. With reference to the above discussion of the "technical" nature of excise duty legislation, it can be stated that with harmonization, if not before, the problems of the application of the law have become every bit as much questions of principle as they are, for instance, in the case of income tax. For example, when irregularities occur in the transfer of products subject to excise duties between Member States (e.g., the disappearance of products during shipment), very serious problems of interpretation indeed can arise in trying to determine the Member State in which the excise duty is to be charged and the party liable to pay it.

### **3 The Development of Excise Duties in Finland Prior to Membership in the EU**

Mention was made above of the difficulty involved in trying to find the historical equivalents of certain present-day taxes. As excise duties can today be implemented in a far more sophisticated fashion than centuries ago, and the legislation with regard to liability to pay and the determination of such duties differs markedly from what it was in the past, it is impossible in practice to carry out a straightforward comparison of taxes levied in different historical periods. Furthermore, it should be borne in mind that the term excise duty was not used

in Finnish legislation until 1919, when the Act on the Excise Duty on Manufactured Tobacco was enacted.

In seeking the roots of the present excise duties, one is well advised to proceed from the objects of taxation and investigate the consumption taxes historically imposed on alcoholic beverages and tobacco products, for example. The present article will concentrate on the development of excise duties in Finland since the country's independence in 1917.

### ***Independence (1917) as a Burden on State Finances***

The attainment of independence and the Civil War brought significant new burdens to the Finnish state economy. Aggravating the situation further was the downturn in foreign trade due to World War I, which meant a substantial decline in the customs revenues that had been the core of state revenues. The Prohibition Act, which came into force in June of 1919, reduced revenues from the tax on alcoholic beverages. The developments compelled the state to look for new sources of income. Income tax was one significant source, but excise duties had a noteworthy role to play as well. Excise duties on tobacco products were first levied in 1919; 1922 saw a duty on matches; and sweets became subject to excise duties in 1926. Of these three, the excise duty on manufactured tobacco has maintained its position in the taxation system through the present day.

As *the excise duty on manufactured tobacco* was in a sense a new form of taxation, the government's justification for enacting it was rather limited. It was considered possible to increase the tax on tobacco products because the only tax levied at the time – the customs duty – was quite low in relation to the price of tobacco. The case of the tobacco duty also shows some features of what is known as the luxury tax approach. In 1939, the focus of tobacco taxation shifted from customs to excise duties; at the same time, the tax was differentiated in that the excise duty on cigarettes was higher than that on other tobacco products.

The notion of luxury tax also figured alongside consideration of state finances when *the excise duty on sweets* was enacted. This duty was originally designed to be a temporary one, but ultimately retained its position in the tax system all the way through the year 2000.

*The excise duty on matches* was levied for the first time following independence from 1922 to 1937. Its justification, in addition to the need for state revenues, was that matches were often used when smoking, whereby the tax constituted a luxury tax on smokers.

The percentage of total state revenues from excise duties remained constant in the 1920s at somewhat less than 10%. The principal source of revenue at that time was customs duties: from 1922 to the end of the decade they accounted for over 50% of all state tax revenues.

### ***The 1930s Recession and the Repeal of Prohibition***

Three new excise duty laws were enacted in the 1930s before the beginning of World War II. *The excise duty on malt beverages* and *the excise duty on*

*alcoholic beverages* were collected beginning in 1932, and the duty on margarines and animal feed starting in 1934. Taxes have been levied on various alcoholic beverages since that time through the present day.

Shortly after Finland achieved independence, the Prohibition Act had come into force, which meant a considerable drop in the tax revenues on alcoholic beverages that had been collected previously. Moreover, pursuing temperance and the other aims of the Prohibition Act gave rise to other problems, with smuggling and other criminal activity burgeoning. With the deepening of the recession in the early 1930s and the consequent need for additional state income, the fate of the Prohibition Act became sealed. The Act was repealed and the excise duty on alcoholic beverages introduced. The alcohol legislation enacted at the time created the basis for a system which persisted until the 1990s in Finland, the characteristics of which were a strict monopoly on alcohol and extensive, multi-tiered supervision of the production and sale of alcohol. A state monopoly was seen as being the best means of achieving the goal for public health and social policy associated with the legislation on alcohol.

*The excise duty on margarines and animal feed* that was levied from 1934 to 1942 can be regarded as the first excise duty in Finland whose enactment was not motivated principally by fiscal considerations. The aim of the duty was to regulate the difference in price between butter, produced domestically, and margarine, largely manufactured using imported ingredients, so as to protect domestic production.

The adoption of new excise duties could be seen in the rise of their share of overall state tax revenue to 15 % in the 1930s. Customs duties retained their position as well, accounting for between 50% and 60% of state tax revenues during the period 1930 to 1938.

### ***War and Exceptional Circumstances Change the Excise Duty System***

A state of war and the need for additional revenue it engenders often causes changes in a system of taxation. It may become necessary to impose new taxes or to at least raise existing ones substantially. World War II was no exception in this respect. Doubtless the most important new tax that emerged at the time was the turnover tax (the present value-added tax), which was collected starting in 1941. Changes also occurred in the system of excise duties. At the end of the 1930s and the beginning of the 1940s, four new excise duties were adopted - duties on rubber car tires, coffee, sugar and soft drinks – and the duty on matches was reinstated. In addition, most of the existent taxes were increased. The new taxes and tax increases were designed not only to cover the costs of the War but also replace customs duties, revenues from which had collapsed with the virtual cessation of foreign trade. Whereas customs duties constituted some 50% of state tax revenues in 1938, by 1945 they accounted for a mere 2%. The exceptional circumstances brought about by the War were also reflected in the fact that certain products subject to excise duties or the raw materials used in their manufacture were rationed, which reduced revenues from excise duties.

One excise duty still collected today that originated during the War is that on *soft drinks* (1940). Soft drinks were considered a suitable object of taxation as

luxury goods and in this sense were likened to sweets. Products made from domestic berries, fruits and plants were exempted from the duty.

The first excise duty in Finland related to road traffic was that levied on *rubber car tires*. One objective of the tax was to cover the costs to society of road traffic. The excise duty was levied between 1939 and 1964.

*The coffee tax* was enacted in 1939. Coffee, along with sugar, was one of the first products to become rationed as a result of the exceptional circumstances caused by the War. However, it was not considered necessary for the consumption of coffee to be regulated in its entirety, and free trade in coffee was allowed to a certain extent. However, as the consumption of such coffee during a period of rationing was considered a luxury, the taxing of it was deemed appropriate as part of the effort to ease the state's difficult economic situation. The tax on coffee was levied through the end of 1942, when coffee ceased to be available altogether. The tax was introduced again in 1948.

*The Act on the Excise Duty on Sugar* was passed in 1939 and the tax was collected for some ten years at that time.

In 1940, collection of the match tax was resumed. The re-introduction of the tax was linked to the need for revenues occasioned by the war, but it continued to be collected long thereafter, until the end of 1964.

Revenues for excise duties all but quadrupled during the war. The increase was not, however, nearly as great as that from income and wealth tax, revenues from which rose almost tenfold. In fact, the revenue lost in customs duties was replaced by income and wealth taxes as well as turnover tax rather than by excise duties. The proportion of total state tax revenues from excise duties remained essentially the same as it had been in the 1930s, i.e., somewhat over 10%. In 1940, however, the proportion was exceptionally high, 27.5%. In this connection, it should be pointed out that the turnover tax introduced after this, in 1941, naturally reduced the percentage of revenues accounted for by existent taxes.

### ***Domestic Oil Refining Leads to a Fuel Tax***

As far as the objectives are concerned, excise taxes developed after the war largely as they had before it. The development of and changes in the system of excise duties were mainly guided by considerations of the state economy.

In the first years after the War, a *gold tax and silver tax* were levied. The imposition of both taxes was justified by the exceptional circumstances of the War. The duties were not directly motivated by financial concerns but, rather, a desire to regulate the price of domestically produced gold and silver and to prevent speculation. The taxes represented an attempt to influence the price of gold and silver.

The coffee tax was re-introduced in 1948 and collected through the end of February 1954, at which time rationing of coffee was discontinued.

The year 1957 was a milestone in the development of the Finnish system of excise duties; it marked the introduction of *the excise tax on fuels*, which was to become the most important excise duty with respect to state tax revenue. The excise duty on fuels can be examined from a variety of perspectives within tax

policy. First of all, it has played a central role in the taxation of road traffic, where the focus is the various fuels that are refined from crude oil. Debate on tax policy has considered the objectives of taxes on road traffic and the focus of different taxes since vehicular traffic first began to be an issue. The development of taxation of fuels has in fact been closely related to the development of road traffic taxation as a whole. Fuel taxes can also be broached in the broader perspective of energy policy and energy taxation. Here, the principal issue is the use of different fuels as sources of energy in industry and households as well as how the use of respective sources of energy is affected through taxation.

The introduction of the excise duty on fuels in Finland was connected with the rise of domestic oil refining. The intention was to tax domestically produced fuels in the same way as corresponding imported products. Imported fuels were subjected to customs duties, while domestically manufactured products were taxed in the form of excise duties. The fuel tax thus differed from most other excise duties in that it was not originally aimed at imports; rather soon after its introduction, however, it began to be levied on imported fuels as well.

As early as in 1958, the excise duty on fuels had become the second most important excise duty in terms of revenue after the excise duty on manufactured tobacco. In 1965 it surpassed tobacco tax to become the principal source of tax revenues among the excise duties. The introduction of the excise duty on fuels also affected the overall revenues from excise duties, with the revenue from the duties rising over the course of the 1950s and reaching 14.5 % in 1959. All in all, the development in the revenues obtained from excise duties remained relatively constant, for in the period under consideration (1946-1959) even at their lowest level excise duties accounted for 8.4 % of total state tax revenues (1946). Revenues from customs duties gradually began to rise again after the exceptional circumstances of the War and in 1949, for example, they surpassed those from excise duties. However, turnover tax as well as income and wealth tax had become far greater sources of state revenue than customs and excise duties. At their greatest, turnover tax accounted for 43.2% (1951) and income and wealth tax for 38.2% (1947) of state tax revenues.

### ***Free Trade Agreements and Agricultural Policy***

After the end of World War II, international trade could again develop normally. Characteristic of the development since that time have been efforts to free trade and to increase the related economic cooperation. Finland was one of the countries involved in this cooperation. In 1961 it concluded a separate free trade agreement with the members states of the European Free Trade Association (EFTA). In 1985 it became a member. The free trade agreement concluded with the European Economic Community (EEC) came into force in 1974. A number of agreements were also made with then-socialist countries on reciprocally eliminating obstacles to trade. The final stage of this development that had begun in the 1960s prior to Finland's joining the European Union was the agreement on the European Economic Area that came into force in 1994. Finland has also committed itself to the elimination and reduction of customs duties agreed upon under GATT.

The range of international obligations affecting the trade in goods brought changes to the Finnish system of excise duties. For example, in some cases, such as fuels and malt beverages, taxes previously levied in the form of customs duties were now replaced by excise duties. In addition, it became necessary to amend certain provisions in the legislation on excise duties, which were seen as discriminating against products of other signatories in favor of products made in Finland; e.g., the exception in soft drink taxation for products manufactured from domestic raw materials was discontinued.

The free trade agreements concluded also had their impact on agricultural policy in Finland. For example, due to the difficult conditions under which food is produced in Finland, the prices of domestic agricultural products were often higher than those available on world markets. This required that domestic production be protected from imports through import duties, for example, if domestic agricultural products and foodstuffs manufactured from them were to be competitive. The free trade agreements did not allow such a system to continue. In 1964, an *excise duty on food products* was enacted that included a special system for equalizing differences in the prices of raw materials. An excise duty of equal amount was levied on both domestically produced and imported foods, with a domestic producer nevertheless entitled to receive a refund corresponding to the difference between the domestic and world market prices of the raw materials used in making the product in question. In this way, the food industry was able to obtain agricultural products at world market prices.

The Finnish system of excise duties included a number of other taxes whose objectives fall within the scope of agricultural policy, e.g., *the excise duty on dietary fats* (1959), *sugar* (1975), *fertilizer* (1976) and *animal feed mixtures* (1979).<sup>8</sup> These excise duties were designed to support domestic production and regulate the relative prices of agricultural products. Excise duties have also been used to cover the costs of overproduction where overproduction has compelled the state to provide financial support for the export of domestic products. On the other hand, excise duties have been used to combat overproduction itself, for example, by levying taxes on fertilizers in order to check the increase in their use.

The oil crisis at the end of 1973 and beginning of 1974 led to the state's discontinuing the collection of turnover tax on fuel. The tax, a percentage tied to the sales price of the product, would have exacerbated the rise in the price of fuels even further. The turnover tax was replaced by an excise duty defined in terms of a certain sum per unit. The excise tax on fuels was thus broadened in scope to include fuels in addition to those used in traffic. One of the crucial energy sources, *electricity*, was also taxed in Finland using a separate excise duty from 1976 to 1986. Enactment of the electricity tax was justified with reference to the need to place electricity in a position equal to that of other forms of energy. At the time electricity was the only significant source of energy that was not taxed in any way.

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<sup>8</sup> The figure in parentheses is the year in which the tax was first introduced. However, these duties have not always been collected for very long periods. Moreover, the goods taxed and thus the names of the Acts determining these vary to a certain extent. As the focus here is on major trends, space precludes explanation of this variation.

A range of excise duties that were enacted to serve various purposes of agriculture and foreign trade served to bring diversity to the objectives of the duties, which for the most part had previously been fiscal in nature. Connected with this broadening of aims is the emergence of environmental considerations in the mid 1970s. Since 1976, the so-called surtax on soft drinks and alcoholic beverages has been used to limit the sale of certain of these products in disposable containers.

The enactment of new excise duties in the 1960s and, in particular, the 1970s meant a strengthening in their position in the state economy. In certain years in the 1970s, excise duties accounted for over 20 % of total tax revenues. Customs duties continued to be more important sources of revenue than excise duties in the early 1960s, but the effect of the free trade agreements soon made itself felt as a rapid decline in these revenues. For example, in the latter half of the 1970s, customs duties accounted for a mere 2% of total state tax revenues. Although excise duties comprise a number of different taxes, it can be said that since 1962 they have been the third largest source of tax revenue for the state after income tax and turnover (value-added) tax. Income taxation is fiscally the most important form of taxation for public corporations when municipal taxation is taken into consideration.

### ***The Rise and Strengthening of Environmental Objectives***

The 1980s saw no major changes in the objectives associated with excise duties. However, environmental policy began exerting an increasing influence as environmental concerns were first taken into consideration in imposing excise duties on fuels in the 1986 reform of energy taxation. The tax on petrol was graduated so that the tax was lower on environmentally friendly lead-free petrol than on leaded products. The reform of 1986 was also significant in that a transition was effected from what had mainly been a system based on excise duties to one based on turnover tax. Only road traffic fuels, i.e., petrol and diesel fuel, were still subject to both excise duty and turnover tax. On balance, fuel taxation had essentially reverted to the system that had existed before 1974 and the Oil Crisis.

The percentage of state tax revenues from excise duties declined as a rule over the course of the 1980s. Where the figure was 23.4 % in 1980, in 1989 it had dropped to 13%.

The most recent trend in the Finnish system of excise taxes where the objectives of taxation are concerned is the notion of an environmental tax. As mentioned above, environmental objectives appeared in the excise tax system for the first time as early as the 1970s. However, in the 1990s the notion of an environmental tax became more common and stronger. *The phosphorous fertilizer tax* (1990) was the first excise duty to be enacted solely for environmental ends. By increasing the price of fertilizers, the tax was to reduce the use of fertilizers containing phosphorous, which were damaging to watercourses. Later, the Act on the Excise Duty on Fertilizers and the Act on the Excise Duty on Phosphorous Fertilizers were combined, with the new legislation

taking into account the environmental problems caused by nitrogen fertilizers as well.

A significant change in fuel taxation was the extension of environment-based taxation to include energy sources other than road traffic fuels. As of 1990, excise duties on fuels were levied on important fossil fuels in addition to petrol and diesel oil in order to curb energy consumption and to reduce the environmental damage resulting from the production and consumption of energy. The tax came to include coal and lignite, milled peat, light fuel oil, heavy fuel oil and natural gas. The amount of tax depended on the carbon content of the product. In 1993 a new graduation of the environment-based fuel tax was carried out in which the tax on petrol and diesel fuel having cleaner exhaust emissions, i.e., reformulated varieties of the fuels, is lower than that on conventional fuels. From the point of view of the energy taxation reform overall it should be pointed out that the state's difficult financial situation led to re-introduction of the electricity tax in 1993.

The structure of fuel taxation was changed again in 1994 with the goal of developing energy taxation more in keeping with environmental objectives. Taxes on fossil fuels were increased when it was decided that a tax based on the carbon content of the energy source was the most efficient means of limiting emissions in energy production and promoting the saving and efficient use of energy.

### ***Reforms in the Taxation of Alcohol***

The taxation of alcohol underwent many changes in the 1990s. The most significant of these have been consequences of economic integration. The EEA agreement already required equitable practices in the taxation and pricing of alcoholic beverages. This principle rendered problematic the pricing system used in Finland for alcoholic beverages and the tax-like surplus remitted to the state by an alcohol company with monopoly status. In deciding on the prices of the alcoholic beverages being sold, the alcohol company had previously had the opportunity to place domestic and imported beverages in unequal positions by adjusting its surplus. This ran contrary to the EEA Agreement. The Agreement also rendered it impossible for the taxation of alcoholic beverages to be based on the retail price set by the board of directors of the company. In 1994 it was decided that the sum corresponding to the tax-like surplus of the alcohol company would be collected in the form of an excise duty on alcoholic beverages. The duty itself was changed in anticipation of the tax structure applied in the EU whereby the excise duty on all alcoholic beverages was based on the alcohol content of the product.

The EEA Agreement also resulted in certain changes in agricultural excise duties, and these duties were ultimately discontinued when Finland joined the European Union.

One factor having a marked influence on excise duties in the 1990s in Finland was the difficult economic situation that prevailed in that decade, one that forced the state to seek new objects of taxation and to raise existent taxes. Accordingly, the revenues from excise duties in the overall state tax revenues rose over the

course of the decade from somewhat less than 15% to some 20%. This trend can be explained in part by the fact that the high unemployment at the time reduced the role of income and wealth tax in state taxation; the absolute amount of revenues from excise duties nonetheless rose in the period concerned.

#### **4 Finnish Membership in the EU and the Overall Reform of the System of Excise Duties**

Finland's participation in economic cooperation with other states through free trade agreements brought about changes in the system of excise duties starting in the 1960s. Finland then committed itself to cooperation with even more far-reaching goals when it joined the European Union in 1995. The consequences of membership for the system of excise duties were also more profound. One such change was the total elimination of agricultural excise duties from the system of taxation. The fundamental considerations that had motivated these taxes in the first place changed crucially with membership because the Community has what is known as exclusive competence when it comes to implementing agricultural policy. This means that Member States cannot pursue a national agricultural policy or issue national provisions on matters which have been prescribed at the Community level. Once Finland began applying the common agricultural policy, it was no longer necessary to finance the export of agricultural products and food from domestic sources of funding.

The changes in the system of excise duties occasioned by Finnish accession to the EU derive fundamentally from the fact that, according to the Treaty of Rome, excise duties fall into the category of what are known as *harmonized taxes*. The harmonization of certain excise duties has been closely connected with the creation of the internal market, in which goods as a rule move freely between Member States without taxation or control measures at borders. It was considered impossible to discontinue border checks without harmonizing excise duties, for extreme variation in taxation and the level of taxation in different Member States could lead to distortions of competition. As to date agreement has been reached at the EC level only on certain minimum tax amounts, harmonization is still ongoing and problems involving competition still arise.

Harmonized taxes expressly include excise duties on mineral oils, alcoholic beverages and manufactured tobacco products. Harmonization has been carried out principally through directives, which Member States must transpose into national legislation. The transition to a harmonized system of excise taxes also required a comprehensive reform of the relevant legislation in Finland. The year 1995 saw the coming into force of the Act on Excise Duties (1469/1994) as well as certain product-specific Acts, e.g., the Act on Excise Duty on Tobacco (1470/1994), the Act on Excise Duty on Alcohol and Alcoholic Beverages (1471/1994), and the Act on Excise Duty on Liquid Fuels (1472/1994).

Member States have in fact the right to levy a *national excise duty* on products in addition to those falling within the scope of harmonized excise taxation provided that such taxes do not give rise to border-crossing formalities in trade between Member States. In Finland national excise duties have been

considered necessary for reasons of the state economy and environmental concerns. One exclusively national excise tax act is the Act on Excise Duty on Sweets and Soft Drinks (1474/1994). Collection of the excise duty on sweets was discontinued in 2000, however, when Finland and the Commission of the European Union disputed whether the tax-exempt status granted to xylitol sweets was in violation of the provisions in the Treaty prohibiting discrimination in taxation. Express measures to harmonize taxes are thus not the only considerations in Community Law that impose restrictions on the self-determination of Member States where taxation is concerned.

As Finland levied taxes on other fuels in addition to mineral oils before accession, decisions had to be made on whether such taxation would continue on a national basis. Environmental concerns were invoked to justify taxing coal, electricity, natural gas, milled peat, sod peat and pine oil. The taxation of these fuels is set out in the Act on Excise Duty on Electricity and Certain Fuels (1260/1006).

Although the number of excise duties in Finland decreased when the country joined the EU, the significance of this form of taxation for the state economy is still considerable. However, the proportion of excise duties in total state tax revenues has declined: whereas in 1995 it was still some 20%, in 2000 it was approximately 15%.

The table below presents an overview by decade of the revenue produced by certain taxes. The figures in the table reflect the total yield of each tax in a given decade (the figures for the 1990s are based on the period 1990-1998) in order to determine the percentage of total state tax revenue accounted for by that tax in the decade in question. The total percentages then appear in the rightmost column.

	Excise duties	Customs duties	Turnover/ Value-added tax	Income and wealth tax	Total
1920s	9.7 %	54.1 %		23.0 %	86.8 %
1930s	13.5 %	54.0 %		24.5 %	92.0 %
1940s	11.0 %	9.5 %	29.9 %	32.1 %	82.5 %
1950s	10.5 %	16.0 %	33.9 %	32.9 %	93.3 %
1960s	15.9 %	7.3 %	29.8 %	30.4 %	84.4 %
1970s	19.7 %	1.9 %	29.1 %	33.3 %	84.0 %
1980s	16.9 %	1.3 %	34.6 %	33.4 %	86.2 %
1990s	18.1 %	0.6 %	35.6 %	34.4 %	88.7 %

From the point of view of the state budget, the greatest changes in the Finnish tax system since independence are those that have affected the position of customs duties. Following Finland's accession to the EU, these duties have lost their significance for the state economy almost entirely. Since 1998, revenue from customs duties has no longer been mentioned separately in the state accounts, as the year marked the end of exceptional transitional arrangements.

With the exception of a certain collection fee that it receives, Finland must now remit all revenues from customs duties to the EU.

The trend in revenues produced by excise duties in Finland since independence has been rather consistent in comparison to that for customs duties, the range being a mere ten percent. The significance of excise duties for the state economy was greatest in the 1970s, when the percentage of revenues from excise duties was almost 20%. Excise duties continue to constitute a significant source of income for the state. It is a form of taxation that not only supports the state economy but also may serve different socio-political aims within the bounds permitted by EC norms.

## **5 Future Prospects**

One of the central issues in taxation in Finland today is how it might be possible to achieve the desired reduction in the level of taxation of earned income. Here it is worth considering a shift in the focus of taxation towards the taxation of consumption by developing new items to be taxed through excise duties or by raising existent excise duties. The actual opportunities in this area are rather limited, however, owing to the country's obligations as a Member State of the EU. That the revenues from excise duties have remained at their pre-accession levels since 1995 is largely a consequence of the fact that to date only certain minimum levels of taxation have been defined for harmonized excise duties; the situation may change as progress is made towards increased harmonization. Any assessment of the future of the system of excise duties must also take into account the impact of international tax competition and market forces.

In particular, revenues from the excise duty on alcoholic beverages may decline substantially by 2004 at the latest with the cessation of the derogation granted Finland regarding taxation of goods imported by travellers entering the country from another Member State. This will then mean a transition to the basic system of excise duties in the EU that entitles private individuals to bring alcoholic beverages acquired in another Member State into Finland for their own use without having to pay tax on them a second time. If the tax on alcohol is not lowered, there is a risk that the proportion of tax-free beverages brought into the country in the total consumption of alcohol will become too great vis-à-vis domestic sales. A decline in domestic sales may have not only significant repercussions for the state economy but also substantial consequences for business life.