



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

in accordance with Article 19(1) of Council Directive 2003/96/EC (regional derogations)

1. INTRODUCTION

In accordance with Article 19(1) of Council Directive 2003/96/EC¹ restructuring the Community framework for taxation of energy products and electricity (hereafter referred to as the "Energy Tax Directive" or the "Directive"), in addition to the provisions foreseen in the Directive, in particular in its Articles 5, 15 and 17, the Council acting unanimously on a proposal from the Commission, may authorise any Member State (that requested so) to introduce further tax exemptions or tax reductions for specific policy considerations.

The Commission shall examine the request. Afterwards, it shall either present a proposal to the Council or, alternatively, shall inform the Council of the reasons why it has not proposed the authorisation of such a measure.

Within a broader framework of review of derogations expiring in the Energy Tax Directive by the end of 2006, Italy submitted three requests for authorisation to derogate from 2007 onwards from the provisions of the Energy Tax Directive and to apply regionally differentiated rates of taxation to selected energy products in certain geographical areas. The requests were registered with the Directorate General for Taxation and Customs Union².

The purpose of this communication is to inform the Council of the reasons why the Commission does not propose the authorisations requested.

2. SUMMARY OF THE REQUESTS

- (1) Italy would like to apply full tax exemption within an annual quota to certain energy products consumed in the territory of the region of Val d'Aosta.

The annual tax exempt quota is set at regional level. The measure applies to motor fuels (petrol, diesel) and also to certain heating fuels (LPG for domestic heating). For each group of energy products the potential beneficiaries are clearly identified and in most of the cases these are private individuals resident in the particular region.

According to the Italian authorities, the objective of the measure is to avoid so-called tank tourism i.e. the practice by citizens of crossing borders to avail of lower fuel prices. Italy refers to the location of the region at the external border with the EU. The measure is further aimed at avoiding negative consequences of the expiry of the derogation contained in Annex II of the Energy Tax Directive that would lead to loss of welfare.

Italy considers that the measure can be justified on the basis of the geographical and infrastructural aspects of the region – a mountainous area highly dependent on road motor transport. Furthermore, Italy refers to the specific Constitutional status of the region and to Community policy of economic and social cohesion that attributes special attention to mountainous areas. With respect to LPG used for heating purposes, Italy refers to the severe climatic conditions of the region.

¹ Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for taxation of energy products and electricity (OJ L 283 of 31.10.2003 p. 51); Directive last amended by Directives 2004/74/EC and 2004/75/EC (OJ L 157 of 30 April 2004, p. 87 and p.100).

² On 17 October 2006.

- (2) Italy would like to apply full tax exemption within an annual quota to certain energy products consumed in the territory of the province of Gorizia.

The annual tax exempt quota is set at regional level. The measure applies to motor fuels (petrol, diesel) and also to certain heating fuels (natural gas for domestic heating, mineral oils for business heating). For each group of energy products the potential beneficiaries are clearly identified. With the exception of heating oils, the beneficiaries are private individuals resident in the province.

According to the Italian authorities, there are historical reasons for the measure that are justified by the socio-economic weakness of the territory, which is, in particular, caused by the specific geographical location of the area. According to Italy the expiry of the derogation will lead to a reduction in demand for the energy products (due to tank-tourism abroad), reduced welfare and related economic activity.

The Italian authorities are of the view that due to the insufficient degree of excise harmonisation within the EU, application of the standard tax rate following the expiry of the derogation in Annex II of the Energy Tax Directive would not lead to any increase of tax revenue as the entire demand is expected to move abroad. Finally, with respect to the natural gas, Italy points to the environmental advantages of this fuel over mineral oils, and highlights the positive experience that this measure has had for the deployment of natural gas network in the province.

Italy considers that the measure can be compatible with the relevant Community policies based on the particular geographical location and socio-economic weaknesses of the area, which falls under the terms of Article 87(3)(c) of the EC Treaty and is admissible to EU Structural Funds.

- (3) Italy would like to apply reduced rate of taxation to mineral oils consumed in the provinces of Udine and Trieste, provided that the rates are in accordance with the obligations set down in the Energy Tax Directive.

The measure is applied in the form of tax exempt annual quota for petrol and diesel and its geographical scope is restricted to the province of Trieste and to some communes in the Eastern part of the province of Udine. The beneficiaries are private individuals, mostly residents in the areas.

The objective of the measure is to avoid so called-tank tourism. Italy points out that the expiry of the derogation in Annex II of the Energy Tax Directive would have a negative socio-economic impact, would not give result in any increase in tax revenues and would lead to the closure of station services in the area.

All three requests foresee date of termination by 31 December 2012.

3. BACKGROUND TO THE REQUEST

In the past, some Member States, and Italy in particular, were authorised under the procedure referred to in Article 8(4) of Council Directive 92/81/EEC³, to apply reduced rates of taxation or exemptions from taxation for specific policy considerations in certain geographic areas or regions, linked either to economic development or to geographical particularities (climate, location) of such zones. Furthermore, certain regional schemes were implemented with the aim of discouraging so called tank-tourism.

In its June 2006 Communication *Review of derogations in Annexes II and III of Council Directive 2003/96/EC that expire by the end of 2006* (hereafter referred to as "the 2006 Communication")⁴ the Commission highlighted two main problems related to this kind of derogations viz. the suitability of excise duty as an instrument to tackle regional specificities of socio-economic nature in the first place and the interest in creating an internal market of undistorted competition in the second. The Commission stressed that the concept of minimum rates serve the interest of the internal market and that, if necessary, minimum rates could be adjusted.

The communication however concluded that it is up to the Member States concerned to consider whether, for specific policy considerations, a derogation from the Directive was still necessary and, if so, whether it could be compatible with the objectives of the Directive, i.e. with the interests and policies set out in its Article 19 (1), third indent.

4. EVALUATION BY THE COMMISSION

At the outset, the Commission would like to recall the wording of Article 93 of the EC Treaty which is the basis for Community action in the field of indirect taxation. It requires *harmonisation of indirect tax legislation to the extent that is necessary to ensure the establishment and functioning of the internal market*.

To this end, minimum levels of taxation are set in the areas concerned by excise harmonisation, including in the Energy Tax Directive. Bearing in mind that Member States may fix their own national rates in compliance with the minima, and in accordance with what they consider appropriate in the context of their national circumstances, minimum levels of taxation are set at a level which the Community legislator considers necessary to keep potential distortions of competition within an acceptable margin.

The absence of fully harmonised rates implies that differences in national rates may exist and that these may lead to a degree of tax-induced cross-border shopping within the internal market and the limits prescribed by Articles 8 and 9 of Directive 92/12/EEC, where applicable. However should any resulting distortions exceed boundaries which are no longer considered acceptable and in accordance with the logic of harmonisation set out above, the appropriate remedy would be to seek a closer effective approximation of national rates on the

³ Council Directive 92/81/EEC of 19 October 1992 on the harmonization of the structures of excise duties on mineral oils (OJ L 316 of 31.10.1992); Directive repealed together with Council Directive 92/82/EEC of 19 October 1992 on the approximation of the rates of excise duties on mineral oils as from 31 December 2003 by means of Council Directive 2003/96/EC.

⁴ COM(2006) 342 of 30 June 2006 *Review of derogations in Annexes II and III of Council Directive 2003/96/EC that expire by the end of 2006*.

basis of Article 93 EC, be it through upward revision of minimum levels of taxation or through other means the Community legislator may choose.

Therefore, the Commission rejects Italy's view according to which insufficient excise duty harmonisation could justify, under Article 19, a request for derogation from the provisions of the Energy Tax Directive. This justification does not correspond to a "specific policy considerations" within the meaning of Article 19. The minimum levels of taxation chosen in the Directive constitute in fact the main element that has been considered by Community legislator. On the basis of the levels chosen, the Community legislator has concluded that Member States have no longer any valid reasons to differentiate their rates at national level in order to react to the levels set in other Member States, outside the mechanisms provided for in the Directive itself. If it were otherwise, rates for motor fuel at borders between Member States would risk being set through a bilateral and progressive mechanism of downward adaptation to the harmonised minima, which is not foreseen in the Directive.

No element of the Energy Tax Directive allows a different interpretation.

As far as the horizontal arguments raised by Italy in each of its four requests are concerned:

First, regarding the argument according to which the regions concerned benefit from a specific constitutional status under Italian law, the Commission would like to point out that this argument is not sufficient for the purposes of Article 19. While it is not excluded that certain considerations presenting a regional point of reference may constitute specific policy considerations under Article 19, the status of a region under national constitutional law does not, as such, correspond to this notion.

Secondly, the Commission cannot accept the general arguments put forward by Italy concerning the socio-economic position of certain regions (either due to external economic competition, to its particular geographic location or other geographical aspects of the areas). These arguments come to say that the regions in question are in need of public support. However, the derogations granted so far have never been formally considered as an instrument of policies conducted to this effect, and any "prolongation" under this heading cannot thus be accepted under Article 19. In addition there are much more targeted instruments and policies available⁵ to deal with such problems and which do not undermine the useful effect of harmonisation of excise duties in the field of energy products.

Thirdly, as regards the specific geographical location of some of the areas are concerned, namely close to the Italian borders, the Commission refers to what has been set out above. It follows that the neighbourhood of another Member State with different taxation levels cannot be accepted as a sufficient reason to grant an authorisation under Article 19 of the Energy Tax Directive. In particular, derogations justified by the fact that, at the time, the neighbouring State has been a third country cannot now be prolonged under Article 19, after the accession of the State in question to the Community and in view of the ensuing obligations of this State under the Energy Tax Directive. With respect to the external border aspects raised by Italy in one particular case (Val d'Aosta), the Commission notes that the derogation requested does not constitute a proportionate response to the alleged problem of tank tourism. Indeed, it is liable to create itself distortions of consumption patterns within Italy and other parts of the

⁵ When resorting to such instruments and policies, Member States have of course to respect the provisions of Community law, in particular in the field of State aids.

Community, in that consumption of residents is artificially attracted to the region in question, where it also could take place outside. In this respect, it has also to be borne in mind that Val d'Aosta shares the border not only with Switzerland but also with France.

Finally the Commission would like to recall that negative consequences of the expiry of a derogation as such does not qualify as specific policy considerations in terms of Article 19.

It is appropriate, in addition, to consider separately the more specific situations and arguments referred to in the requests.

As far as the alleged dependency on road transport in the region of Val d'Aosta is concerned, the Commission does not consider the measure envisaged, namely a general exemption from excise duties on motor fuels to be a proportionate response to the problem and which would justify an authorisation under Article 19. The Commission notes that Italy has not justified the exemption in question under the policy consideration cited, compared to the treatment of other parts of Italy which are equally rural (i.e. not densely populated) and/or mountainous and where the full national rate is supposed to apply. There is no indication that there is any objective relationship with the extra costs involved, however calculated. Finally, the total exemption of motor fuels would be incompatible with the energy, transport and environment policies referred to in Article 19 (1) third indent of the Directive. A comparison with Article 5, third indent, of the Directive reinforces this conclusion. Reflecting the said policies, this provision shows that local public passenger transport, although liable to be privileged by Member States as compared to private transport (which is at stake here), remains subject to the minimum levels of taxation. Only in the very specific circumstances referred to in Articles 15(1)(e) or 15(1)(i) of the Directive taxation below these levels remains possible.

As far as the arguments referring to energy products used for heating purposes are concerned, the Commission's assessment is as follows.

First of all, the Commission does not consider that the intention to apply more favourable tax treatment to mineral oils used for business heating purposes could be justified. The purpose of the measure is to subsidise enterprises located in a certain area. In its June 2006 Communication, the Commission stressed that the Directive already takes due account of business consumption and potential competitiveness constraints that might arise in relation to energy taxation. In this connection, the Commission would like to highlight that the Council, acting unanimously under the procedure set out in Article 93 of the Treaty, has already established a balance between policy considerations that might plead in favour of more favourable tax treatment of business use. The options set out in the Directive with regard to business use, in particular Articles 5 and 17 thereof, reflect the degree of flexibility the Community legislator has considered appropriate and sufficient in this context. Therefore, considerations of the kind raised by Italy do not qualify as specific policy considerations for the purposes of Article 19. Moreover, the said options of the Directive also reflect the interests set out in Article 19(1), third indent, of the Directive and include the proper functioning of the internal market, the need to ensure fair competition and Community health, environment, energy and transport policies. These very same interests would oppose the granting of the authorisation requested under the present aspect.

To the extent Italy requests an authorisation to exempt consumption of natural gas as heating fuel, the Commission would like to point out that the Energy Tax Directive does indeed take due account of the potential advantages of natural gas. Therefore, Italy's request does not display specific policy considerations in this context (quite apart from the fact that the

advantages of natural gas referred to by Italy do not differ as between regions). The considerations set out above with regard to Article 19(1), third indent and Community environment, energy and transport policies apply here as well and equally plead against the granting of the derogation.

Finally, referring to favourable tax treatment of LPG used for domestic heating in the mountainous region of Val d'Aosta, the Commission considers that this measure overlaps with another measure Italy has submitted to the Commission for consideration under Article 19 of the Energy Tax Directive. In this respect, Italy plans to provide for differentiated tax advantages for LPG as heating fuel, depending upon the climatic situation of certain regions. However, the authorisation requested for Val d'Aosta goes far beyond the other scheme submitted. The Commission concludes that, in Italy's own view, the climatic conditions referred to do not justify the particular regime devoted to Val d'Aosta. The other request submitted by Italy will be considered separately.

5. CONCLUSION

On the basis of the above, the authorisation requested by Italy should not be granted. First of all, with respect to the main argument put forward by Italy in order to justify the requests, it must be stressed that the alleged lack of sufficient harmonisation on the internal market may not be remedied through authorisations under Article 19. Minimum levels of taxation formed part of the main elements the Community legislator considered while adopting the Directive.

Furthermore, the Commission does not either consider acceptable any of the additional arguments presented by Italy, in relation to certain specific parts of its requests.

The Commission therefore does not **propose the authorisations requested**.