



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 5.12.2006  
COM(2006) 768 final

**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL**

**in accordance with Article 19(1) of Council Directive 2003/96/EC (taxation of industrial uses of LPG and taxation of coal)**

## **1. INTRODUCTION**

In accordance with Article 19(1) of Council Directive 2003/96/EC<sup>1</sup> 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 Greece and Lithuania submitted a request for authorisation to derogate from some of the provision of the Energy Tax Directive for certain energy products. These letters were registered with the Directorate General for Taxation and Customs Union<sup>2</sup>.

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**

### **2.1. The Greek request**

Greece would like to apply a reduced rate of taxation to LPG used for industrial purposes equal to EUR 0.29 per 1000 kg of LPG. The applicable minimum levels of taxation (pursuant to Article 8 of the Energy Tax Directive) are EUR 41 per 1000 kg of LPG used as motor fuel.

According to the Greek authorities, the measure has two main objectives. Firstly, to promote the use of more environmental friendly fuel compared to other mineral oils, as a second-best and temporary solution taking into account that the natural gas network has not been completed yet in Greece. In this connection the Greek authorities stress the environmental benefits of LPG. The second objective of the measure is to reinforce the competitive position of domestic industries.

The request does not foresee a date of termination.

### **2.2. The Lithuanian request**

Lithuania would like to derogate from the general provisions of the Energy Tax Directive, in particular its Article 2(1) and not to subject coal to taxation. In other words Lithuania would like to postpone the introduction of taxation of coal.

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<sup>1</sup> 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).

<sup>2</sup> On 13 October 2006 (Greece) and on 29 September 2006 (Lithuania).

According to the Lithuanian authorities the main objective of the measure is to reconstruct and to modernise businesses in remote areas of the country, especially those using coal in their activity. According to the Lithuanian authorities achieving such objective requires a lot of time and therefore there is a need to postpone introduction of taxation of coal. The Lithuanian authorities in this relation underline that the objective of the measure is to promote economic development of remote areas of the country. Furthermore the Lithuanian authorities have stressed the increasing need for low-cost energy sources in an environment with increasing energy prices for oil and gas and they also point to the changes that the national energy system is currently undergoing due to the closure of the Ignalina nuclear power plant.

The request foresees a date of termination by 31 December 2009.

### **3. BACKGROUND TO THE REQUESTS**

Taxation of mineral oils, including LPG has been harmonised in the EU since 1993<sup>3</sup>. Community legislation sets minimum levels of taxation for its motor fuel and heating fuel uses. Reflecting concerns of competitiveness of certain commercial and industrial branches in the EU vis-à-vis third countries, Article 8 of the Energy Tax Directives establishes significantly lower minimum levels of taxation for the use as motor fuel for the corresponding purposes. Within the internal market, these minimum levels aim at establishing a level playing field between businesses.

In this context Greece was initially authorised to apply reduced rates of taxation and exemption from taxation to LPG used for industrial purposes. In 2001 this authorisation was for the last time extended by the Council until 31 December 2006 and was later incorporated into the transitional arrangements of the Energy Tax Directive.

Through the adoption of the Energy Tax Directive, the scope of harmonised excise duties was extended to energy products other than mineral oils, but directly competing with the latter, such as coal. The purpose was to remove distortions of competition between mineral oils and other directly competing energy products not subject to EU-wide taxation and, in addition, to remove distortions of competition between energy consumers in different Member States taxing or not taxing energy products other than mineral oils (cf. the second recital of the Energy Tax Directive).

In order to allow Member States to adapt to the new situation and in particular in order to avoid sudden price increases for newly taxable products, several transitional periods (either general or country-specific) were granted in the Energy Tax Directive. In this context, and given Lithuania's own particular position, this Member State was authorized to postpone taxation of coal, coke and lignite until 1 January 2007.<sup>4</sup>

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

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<sup>3</sup> 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.

<sup>4</sup> Cf. Council Directive 2004/74/EC of 29.4.2004, OJ L 157, p. 87

Communication")<sup>5</sup> the Commission provided an overview of the wide-ranging flexibility already contained in the Energy tax Directive and, in particular, highlighted the logic and motivation underpinning the inclusion of several product-specific or user-specific options. In particular, the Commission stressed that the Directive already takes due account of potential competitiveness constraints that might arise in relation to energy taxation. The Commission also highlighted in this communication the crucial importance attributed in the directive to the taxation of coal.

#### 4. EVALUATION BY THE COMMISSION

The Commission considers that Greece and Lithuania have in their requests mostly advanced arguments that are taken into account in the Directive itself. This refers in particular to the scope of taxation, setting of the minimum levels of taxation and possible tax differentiation for certain products and uses. In providing for the various criteria, the Community legislator, acting in accordance with the procedure set out in Article 93 EC, weighed analogous arguments against the objectives and interests referred to, equally, in Article 19(1), third indent of the Energy Tax Directive, in particular the interest of the internal market and undistorted competition, the Community environment and energy policies.

Notably, the Community legislator took duly into account competitiveness aspects while adopting the Directive. These influenced first of all the setting of minimum levels of taxation according to product and use. Furthermore, the Directive contains an entire set of possible options, available to Member States on the basis of the Directive alone, allowing for additional differentiations in tax rates for different reasons, including competitiveness concerns in some cases. In most of the cases, the minimum levels of taxation must be respected, in order to ensure a level playing field between undertakings on the internal market. Levels below these minima may be applied, as far as business users are concerned, in accordance with the strict conditions set out in Article 17(2) to (4) of the Directive. One of these conditions is that the environmental effect of these minima be maintained through other means.

The minimum levels applicable within the scope of Article 8 of the Directive, lower than the levels fixed in Article 7 (1), have to be seen in this context. Therefore, the reference made by Greece to the competitive position of its industries does not reflect a specific policy consideration for the purposes of Article 19 of the Directive. An unlimited derogation for reasons of competitiveness, as requested by Greece, can therefore not be accepted.

Nor is it appropriate, in this context, to grant a further derogation for a limited period. Greece has already had enough time to adapt to the minimum levels of taxation for LPG given that harmonised minimum levels of taxation for motor fuel for certain industrial and commercial purposes have existed since 1993 and apply to all Member States. Greece has not raised any argument in this context liable to be taken into account under Article 19 of the Energy Tax Directive.

As far as Greece invokes the environmental aspects of LPG, the Commission would like to point out that to its knowledge deployment of natural gas network has indeed been already partially completed, in particular in the most industrialised areas of Greece. Too favourable

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<sup>5</sup> 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.*

tax treatment of LPG, in particular the virtual exemption foreseen by this Member State, could discourage the users from switching to natural gas, which is at least as environmentally friendly as LPG. This would upset the competitive relationship between these two fuels fixed by the Council in the context of Article 8 of the Energy Tax Directive. This competitive relationship, together with other similar relationships, was deliberately set by the Council, acting in accordance with the procedure set out in Article 93 EC. A Member State's different evaluation does not constitute a specific policy consideration within the meaning of Article 19 of the Energy Tax Directive.

With regard to the request made by Lithuania, it has to be recalled first and foremost that the Energy Tax Directive has deliberately extended harmonised excise duties to coal (cf. above). In addition to the aspect of competition between different fuels, this is justified by the need for environmental protection, an aspect the Energy Tax Directive takes into account in accordance with the nature of each energy product. In this regard, the Directive explicitly refers to Article 6 of the Treaty which requires that environmental protection should be integrated into the definition and implementation of other Community policies (6<sup>th</sup> recital). Furthermore, it refers to the Kyoto Protocol ratified by the Community<sup>6</sup> and recalls that taxation of energy products and electricity is one of the instruments available to assist in achieving the objectives of the Protocol (7<sup>th</sup> recital). Yet, among the main fuel categories covered by the Energy Tax Directive, coal has the highest CO<sub>2</sub> emissions.

Against this background, Lithuania's request cannot be accepted to the extent it has to be understood as being based on concerns of competitiveness in general. The Energy Tax Directive deliberately integrates coal into its regime, precisely for reasons of competition, while providing for different variations, as detailed above. Thus, concerns of the said nature cannot be qualified as specific policy considerations for the purposes of Article 19 of the Energy Tax Directive.

It equally follows from the above that, from an environmental point of view, which has also to be taken into account under Article 19, more favourable tax treatment of coal would not be justified either.

The above conclusions are even strengthened by Lithuania's argument whereby coal suffers less from the energy price increase than other more environmental friendly fuels such as natural gas.

Furthermore, it is appropriate to address some additional arguments presented by Lithuania.

Lithuania's request can also be understood as being motivated by the desire to prolong the exemption of coal as a measure of *transitional* nature.

In this regard, it must be stressed that Lithuania was granted a derogation allowing it to exempt coal, coke and lignite from taxation until 1 January 2007<sup>7</sup> fully in line with its request submitted before EU accession in the framework of the granting of transitional periods from

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<sup>6</sup> Council Decision 94/69/EC of 15 December 1993 concerning the conclusion of the United Nations Framework Convention on Climate Change, OJ L 33, 7.2.1994, p. 11.

<sup>7</sup> Council Directive 2004/74/EC amending Directive 2003/96/EC as regards the possibility for certain Member States to apply, in respect of energy products and electricity, temporary exemptions or reductions in the levels of taxation (OJ L 157 of 30 April 2004, p. 87).

the newly adopted directive to the acceding Member States<sup>8</sup>. The purpose of the transitional periods was to allow the Member States concerned to cope with the new requirements introduced by the Directive. In this regard, the Council has found that the minimum rates set by Directive 2003/96/EC are liable to create serious economic and social difficulties and therefore transitional periods are needed (cf. 2<sup>nd</sup> and 3<sup>rd</sup> of Directive 2004/74/EC).

The transitional periods granted under Directive 2004/74/EC in accordance with Lithuania's request took into account, in particular, the aspect relied upon by Lithuania today. It concerns the transition necessary for the Lithuanian energy sector following the decommissioning of the Ignalina nuclear power plant. In this respect, Lithuania requested and was awarded a derogation whereby it may exempt natural gas and electricity until from taxation 1 January 2010, in accordance with the decommissioning programme of the Ignalina power plant.

Given that all these aspects have duly been taken through the adoption of Directive 2004/74/EC, the Commission cannot identify any specific policy consideration in the present context.

Finally, the Commission cannot accept the regional policy argument put forward by Lithuania.

In this respect, the Commission notes that the derogation granted for the period 2004 – 2006 was never intended to serve the objective of reconstruction and modernisation of businesses in remote areas of the country, so that no "prolongation" of the derogation is possible under this heading.

The said objective cannot be accepted, in itself, as a valid policy consideration either, liable to justify the authorisation requested under Article 19 of the Energy Tax Directive. Quite apart from the fact that the favourable tax treatment envisaged is not even limited to certain regions, tax exemption for coal does not appear to be a proportionate response to such a policy objective. Unlike appropriate direct support to specific activities<sup>9</sup>, the tax exemption for coal would not be targeted to corresponding needs of the various situations, but cover consumption of coal indifferently, while undermining without necessity one of the main objects of this taxation, namely to create incentives towards improved energy efficiency and resulting protection of the environment. Moreover, the Commission would recall again that the Energy Tax Directive contains provisions which allow certain concessions with regard to taxation, while preserving the environmental effects it is supposed to yield (cf. in particular Article 17(2) to (4) of the Directive).

## 5. CONCLUSIONS

On the basis of the above considerations, the Commission is of the opinion that the policy considerations presented do not justify the authorisations requested, which would lead to derogations from some of the key provisions of the Energy Tax Directive. Given the terms of the Energy Tax Directive, including the various options it provides for, the competitive concerns underpinning the requests are not in the nature of specific policy considerations for

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<sup>8</sup> COM(2004) 42 of 28 January 2004 *Proposal for Council Directive amending Directive 2003/96/EC as regards the possibility for certain Member States to apply, in respect of energy products and electricity, temporary exemptions or reduction in the level of taxation.*

<sup>9</sup> The grant of which is of course subject to rules applicable in the field of State aids.

the purposes of Article 19. Some aspects of the requests submitted contradict the objectives and interests underlying the provisions of the Directive, equally mentioned in its Article 19. Exemption of coal is not a proportionate response to the reconstruction and modernisation objectives put forward by Lithuania.

Nor are the any reasons which, under Article 19, would justify the authorisations requested as transitional measures.

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