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ENERGY TAXATION IN THE EUROPEAN UNION. PAST NEGOTIATIONS AND FUTURE PERSPECTIVES

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INDEX

INTRODUCTION

EARLY DEVELOPMENTS
- The Treaty
- The Internal Market Programme (IMP)
- A common excise duty framework

THE MINERAL OILS DIRECTIVES
- The rates
- The structure
  - The base
  - Facultative exemptions and reductions
  - Mandatory exemptions

THE 1992 CO2/ENERGY TAX PROPOSAL

THE 1997 ENERGY PRODUCTS TAXATION PROPOSAL
- The rates
- The structure
  - The base
  - Facultative exemption and reduction possibilities
  - Mandatory exemptions

COUNCIL NEGOTIATIONS (1. ROUND)
- Principled opposition in council
- A German compromise proposal

INTERMEZZO
- Diesel fuel crisis
  - Fuel tourism
  - Fuel protest
- Commission Communication on Aviation fuel
- The application of the Treaty rules on state aid
  - Increased state aid control
  - Guidelines for the use of state aid for environmental protection
  - Case law

COUNCIL NEGOTIATIONS (2. ROUND)
- Kick-starting the process
- Enhanced co-operation
- The Spanish Presidency

    New Spanish position
    Political progress
  The Danish Presidency
  The size and scope of business reductions
    Energy-intensive businesses
    Agreements, tradable permit schemes or equivalent arrangements
    Non-energy-intensive businesses
  Tax differentiations
    Quality
    Use
    Business and non-business
    Quantitative consumption
  Various issues
    Business use and the business entity
    Households and charitable organisations
    Energy products used to produce energy products
    Combined power and heat generation
    Air navigation
    Emissions trading
    The use of biofuels for road transport
    Agricultural and horticultural works, etc.
    The application of exemptions and reductions
    Wood, peat and the output taxation of heat
    Tax neutrality
  Dual use and state aid
    From mandatory to facultative
    State aid approval of dual use exemption in Britain
    State and crisis
    State aid solution
  Professional use of diesel
THE FINAL AGREEMENT
THE ENERGY PRODUCTS TAXATION DIRECTIVE
  The rates
  The structure
    The base
    Facultative exemption and reduction possibilities
    Mandatory exemptions
CONCLUSIONS
  State aid
  Emission trading
  Air navigation
  Road transport
  A more coherent and effective EU energy tax framework
  Perspectives

INTRODUCTION

In October 2003 the European Union (EU) Council of Economic and Finance Ministers (ECOFIN) adopted a comprehensive EU Energy Taxation Directive (ETD) covering all main energy products with minimum rates of taxation and a common legal framework[1]. Before had gone a process of more than ten years of hard negotiations conducted by the Member States and the Commission in the Council.

This working paper provides a detailed historical account of the policymaking and negotiation process leading up to the final adoption of the ETD. Starting with the establishment of a common system for the taxation of mineral oil products on the Internal Market in 1992, the paper continues by describing a failed attempt to introduce a common CO2/energy tax in the early 1990s. After this, the 1997 Commission proposal for an energy tax directive is described, followed by an account of the around six years of marathon Council negotiations which predated the final adoption of the ETD under the Italian Council Presidency in the second half of 2003, just in time for it to inter into force on the 1 January 2004. Describing the political and technical discussions preceding each of the elements of the final directive, the historical account should hopefully prove useful as a contribution to the interpretation of the rather complex set of Community energy tax rules that has been established. The historical account is finalized with a critical evaluation of the final directive.

The paper is concluded first by drawing attention to some critical questions concerning state aid, emissions trading, air navigation and road transport that are likely to fill the EU energy tax agenda in the time to come. Second a need to establish a more coherent and effective EU energy tax framework is pointed out and finally some future perspectives for the area of EU energy taxation is drawn up.

EARLY DEVELOPMENTS

The Treaty

The harmonisation of indirect tax structures and rates, and thereby also the taxation of energy products, was foreseen already with the foundation of the European Community in 1957. The Treaty of Rome provided the legal means for the approximation of indirect taxes in the interest of the Common Market[2].

On the basis of the Treaty a customs union was soon established. In the early 1960s a process towards the introduction of a common system of turnover taxes (VAT) was also commenced and by 1977 a general structure, including principles for a uniform VAT-basis, had been established with the sixth VAT directive.

Less progress occurred within the excise duty area. Except for some overall structural arrangements for the treatment of tobacco, the use of excise duties was therefore for a long time mainly

[1] Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity. For law technical reasons electricity is defined separately from the overall definition of energy products in the directive. However, for practical reasons the word energy products will also include electricity in this article.

[2] Article 93 (ex Article 99) stipulates that the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market.

regulated by the jurisprudence of the European Court of Justice (ECJ). Here Member States were compelled to abandon excise duty arrangements benefiting domestic producers to the detriment of producers in other Member States[3].

The Internal Market Programme (IMP)

It was not before a major re-launch of the European integration project in the mid-1980s, that the area of excise duty taxation was to receive real impetus. In 1985 the European Council adopted a highly ambitious Commission programme to complete a large and truly integrated Internal Market by the 31. December 1992.

The Internal Market was defined as an area without internal frontiers in which the free movement of goods, persons, services and capital was ensured. As the need to levy or monitor VAT and excise duties was one of the principal reasons for having frontier checks between the Member States of the European Community, the abolition of tax frontiers became a key element in the move to complete the internal market.

In order to avoid an increase in fraud and evasion following the removal of border controls overall arrangements for the holding, movement and monitoring of excisable products within the Community had to be established. A considerable measure of approximation between national indirect tax rates, together with common structures in those areas where continued differences in national practices would hinder or distort the free movement of goods, furthermore had to be ensured.

In order to bolster the IMP, the European heads of state signed the Single European Act (SEA), which came into force in 1986. The SEA incorporated the internal market objective into the European Treaties and allowed most decisions on the internal market to be taken by qualified majority, thereby ensuring a more effective decision-making process in Council. An important exception to the new rule of qualified majority was however the area of taxation. With most Member States perceiving the authoritative redistribution of economic resources through taxation as being at the very core of national sovereignty, decisions on tax was still to be taken by unanimity.

A common excise duty framework

On the basis of the IMP, the Commission General Directorate for Taxation presented a line of excise duty proposals in the late 1980s. Following an extensive period of intense negotiations, involving several revisions of the original Commission proposals, the Council managed, as one of its major achievements, to unanimously adopt a common framework for the Member State application of excise duties, before the 1992 internal market deadline.

The system contained a horizontal directive, setting out the general arrangements for products subject to common excise duty and on the holding movement and monitoring of such products[4]. The products subject to common excise duties were alcohol, tobacco and mineral oils. The reason for this was mainly revenue driven. Excises on alcohol, tobacco and mineral oils were the most commonly used and, in terms of value, they were the most important indirect taxes after VAT.

The horizontal directive contained common provisions for the holding, movement and monitoring of the three excisable product groups on the Internal Market (e.g. duty suspension, warehousing, chargeable events). The directive furthermore made it mandatory for Member States to exempt diplomatic or consular relations, international organisations and NATO armed forces from the common excise duties. The directive finally specified that Member States should be allowed to maintain taxing other

[3] The ECJ rulings were based on article 95 and 96 of the EEC Treaty which stipulate, on the one hand, that imported products may not be taxed more highly than similar domestic products and, on the other hand, that any repayments of tax on exportation may not exceed the taxes actually paid on the product.

[4] Council Directive 92/12/EEC on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products.

goods, provided that this does not give rise to border-crossing formalities[5]. The excise duty system furthermore contained individual directives for each of the three excisable product groups, containing minimum rates and structural provisions relating to the unique characteristics of their particular markets.

THE MINERAL OILS DIRECTIVES

Two individual directives covered Mineral oils, one providing minimum rates and one harmonising the structures of the national mineral oil excise duty systems[6].

The rates

The rates directive fixed a set of minimum tax rates, differentiated according to the type of mineral oil product (leaded/unleaded petrol, diesel, heavy fuel oil, liquid petroleum gas, methane and kerosene) and to different uses (propellant, heating purposes, industrial and commercial uses) (see appendix A).

While the reason for subjecting mineral oils to common excise duties had been mainly revenue driven, environmental concerns did also play some role during the process. This is shown by a proposed amendment to the rates proposal, specifying a set of higher target rates for petrol and diesel, fixed at a level, as it was stated in the proposal “sufficient to raise the consumer’s consciousness about CO2 pollution and its implications for the environment and in particular the greenhouse effect”[7].

The Council never accepted the environmentally motivated target rates. Instead the rates directive landed on what could best be described as a lowest common denominator, meaning that no Member State had to raise or lower national taxes as an effect of the directive. This i.e. involved a set of extra low minimum rates on industrial and commercial uses. Industrial and commercial uses included stationary motors, plants and machinery used in construction, civil engineering and public works and for vehicles intended for use of the public roadway or which have not been granted authorisation for use mainly on the public highway (See annex A)[8].

The structure

The structures directive further specified the tax base and the chargeable event and it provided further rules for the application of exemptions or reduced rates. Far-reaching consideration had been taken in this regard to respect existing Member State practices, as long as these did not prevent the abolishment of border trade formalities.

In some cases this was done by leaving it up to the Member States themselves whether or not they wanted to apply a certain exemption or reduction. In other cases, when this was in accordance with the general trend of practice throughout the Member States, it was done in the form of mandatory exemptions, securing a level playing field on the Internal Market.

[5] This provision meant that some Member States had to find new tax points for national excise duties. According a Commission official responsible for the area at the time, this lead to some major changes in national tax schemes, the most noteworthy being a change from the taxation of imports to the registration of cars. Some taxes furthermore simply disappeared.

[6] Council Directive 92/81/EEC on the harmonisation of the structures of excise duties on mineral oils and Council Directive 92/82/EEC on the approximation of the rates of excise duties on mineral oils, both of 19 October 1992, as last amended by Directive 94/74/EEC. The Directives are no longer in force.

[7] COM (87) 327 final and COM (89) 526 final.

[8] A special provision was even made, authorising Member States which on the 1. January 1991 did not apply excise duty to heating gas oil to apply a lower rate of 5 Euro per 1000 l.

The base

Included in the tax base were “mineral oils”, which were closer defined by a list of products specified in accordance with the Combined Nomenclature. Mineral oil products used as heating fuel or motor fuel, for which a level of duty was not specified in the rates directive, were subject to an excise duty fixed, according to use, at the rate for the equivalent heating fuel or motor fuel.

The directives furthermore determined that, any other product intended for use, offered for sale or used as motor fuel (including e.g. biofuels), or used as an additive or extender in motor fuels, should be taxed as motor fuel. Finally, it was determined that any other hydrocarbon (and thereby not biofuels) intended for use, offered for sale or used as heating fuel should be taxed at the rate for the equivalent mineral oil. In this regard all solid hydrocarbons (e.g. coal, lignite and peat) and natural gas used for heating purposes were explicitly excluded from the scope of the directives.

While the choice to cover only mineral oils had been driven mainly by revenue concerns, the resulting exclusion of solid hydrocarbons and natural gas from the scope of the directive could be seen as somewhat unfortunate, from both a competition (between energy sources) and environmental point of view.

Facultative exemptions and reductions

Some of the facultative total or partial reduction options given by the directive could be seen as facilitating the promotion of environmental objectives, such as for mineral oils used in combined power and heat production and in the field of pilot projects for the development of more environmentally-friendly products.

Others must have been introduced to promote other overall public priorities or simply for practical reasons, such as mineral oils used in the production of electricity (mainly to facilitate out-put taxation of electricity), for navigation on inland waterways and the carriage of goods by rail (to promote domestic sea and rail transport) and in respect of dredging operations in navigable waterways and in ports.

Others again could only be seen as options to safeguard the competitiveness of certain business sectors, such as mineral oils used in the field of the manufacture, development, testing and maintenance of aircraft and ships and exclusively in agricultural and horticultural works and in forestry and inland fisheries. Member States were finally allowed to differentiate their national energy tax rates in favour of industrial and commercial uses, provided that the rate was not lower than the special low minimum rate these same uses had been given in the rates directive.

Member States were moreover given a special procedure to apply for the Council to authorise further exemptions or reductions. In accordance with the overall Treaty rule of unanimous decision-making within the area of taxation, such authorisations could also only be given by unanimous decision. Still Member States managed to use the option actively over the years, leaving around a hundred such exemptions for individual Member States. Some of these derogations have been introduced to enhance environmental objectives, such as reductions for low-sulphur diesel and LPG, or other overall public priorities, such as regional development and public transport. Others, were more criticisable from an environmental point of view, such as reductions for the incineration of waste oils, fuel used in alumina plants, private planes and pleasure boats and diesel used for commercial transport.

Mandatory exemptions

The mandatory exemptions of the structures directive covered mineral oils used for purposes other than as motor fuels or as heating fuels and mineral oils supplied as fuel for the purpose of air and sea navigation (within Community waters). A mandatory exemption was also made for mineral oils used in the production of mineral oils, by way of not considering the consumption of such mineral oils as a chargeable event.

While securing a level playing field for these uses on the Internal Market, mandatory exemptions could be criticised from an environmental point of view. They not only meant the absence of

common tax incentives, but also completely removed the possibility for Member States to apply the polluter pays principle within these areas.

Non-fuel use

The mandatory exemption for energy products used for purposes other than as motor fuels or heating fuels were intended to cover situations were mineral oils are used for its non-fuel qualities, as a raw material in certain manufacturing processes or as a lubricant, hydraulic fluid, solvent or cleaning product. Good examples of when mineral oils are used as a raw material is in the manufacturing of plastic[9], the "cracking" of mineral oils into various chemical products performed in the petrochemical industry or the refining of raw iron into steel in steel works[10].

The basic logic behind exempting such "non-fuel use" is that when an energy product is not combusted to create heat or propulsion, it is not really consumed, but rather transformed into a new product or used for its non-fuel qualities. As excise duties on mineral oils are consumption taxes, it does not make sense to tax the non-fuel use.

Air and sea navigation

The mandatory exemption for aircraft fuel was based on a provision in the 1944 Chicago Convention on Civil Aviation, established when aviation was in its infancy. The provision prohibited the taxation of aircraft fuel contained in the tanks of an aircraft arriving at a Community airport. When it came to the taxation of aircraft fuel loaded to a carrier at an airport, this was also generally prevented by hundreds of bilateral Air Service Agreements concluded between Member States and third Countries and among Member States themselves. Member States could have introduced the mineral oils minimum tax on EU carriers leaving from EU airports, but then EU carriers would have faced an unfair competition from third country carriers.

The mandatory exemption for motor fuels used in sea navigation within Community waters has been justified by reasons of environmental and transport policy. While such justifications might in some cases hold when it comes to the promotion of some types of sea transport as a more environmentally sustainable mode of transport, as opposed to land or air transport, they are hard to defend when it comes to other types of sea transport, such as e.g. large high speed and fuel intensive ferries. They are even harder to defend when it comes to the exemption of fuels used in fishing boats, which cannot be seen as a much more than a way to safeguard the competitiveness of an, in many ways, environmentally unsustainable European fishing industry.

Mineral oils used in the production of mineral oils

The logic behind the exemption for mineral oils used in the production of mineral oils was probably to avoid situations of double taxation, whereby mineral oil products gets taxed both on the input and on the output side of the production process. However, from an environmental perspective, it is a drawback that mineral oil producers are not given the same tax incentives for mineral oil conservation as other producers are.

THE 1992 CO2/ENERGY TAX PROPOSAL

In the mid-1980s the re-launch of the European integration project also entailed a significant strengthening of the EU environmental policy agenda. Obtaining its own chapter in the Treaties

[9] Plastics are made by altering the molecular structure of the mineral oil.

[10] Mineral oils are here used as a supplement to coke in the process of "oxidation".

with the adoption of the SEA, the environmental policy area had developed into an independent policy regime based on its own principles, ideas and procedural rules, no longer subordinate to the economic goals of the Community (Hildebrandt 1992). Environmental regulation was now going to be seen more as a promise than as a threat to economic development and growth, and environmental priorities were to be integrated into all areas of Community activity.

As part of this new “ecologically modern” drive in EU environmental policy making, officers inside the Commission’s Environment Directorate started to look into the possibilities for increasing the use of economic instruments, such as taxation, in EU environmental regulation. This would be as more efficient instruments of environmental regulation in comparison with traditional, more bureaucratic, instruments of command-and-control. Among a broad range of ideas for Community environmental taxes (including i.e. on motor fuels, CFCs, water and waste) the DG Environment officials also came up with an idea for a Community wide CO2-tax. With a tax on all fossil fuels, according to the contribution of each fuel to the greenhouse problem, the consumption of low or zero greenhouse gas-emitting energy sources was to be promoted throughout the Community by providing economic incentives to encourage fuel switching and improved energy efficiency[11].

The idea for a CO2-tax was the only one of the original DG Environment tax ideas that eventually survived the deliberations of the Commission College. This as driven by widespread ambitions to have the EU play a role of global climate political leadership, a need to prevent distortions to the Internal Market as an effect of the introduction of varying national CO2-tax schemes and finally an emerging economic policy interest in using the revenues from environmental taxation to reduce labour taxes, and thereby create a “double dividend” of both environment and employment improvement. It survived however only in a considerably more moderate form, based on a pragmatic strategy of so-called “no-regret”, meaning that it could be defended purely in terms of economic and energy political objectives, independently of the environmental objectives behind[12].

In spite of the “no-regrets” strategy it was never possible for the, at the time, 12 Member States to agree on neither the CO2/energy tax proposal nor an considerably watered down amended CO2/energy tax proposal presented in 1995. A persistent and strong opposition shown by an effective trans-national network of heavy industrial interests played an important role for the downfall of the CO2/energy tax proposal. The adoption was however also strongly impeded by basic variations in Member State approaches to the issue of CO2-abatement, involving i.e. great scepticism inside many Member State governments towards the very idea of CO2-taxation as an effective way to combat global climate change, even among those governments that were outwardly most in favour of the proposal (See Klok 2002, Skjærseth 1994, Zito 1995). Taking note of the deadlock, the ECOFIN Council on March 1996 called upon the Commission to present new proposals for the taxation of energy products.

THE 1997 ENERGY PRODUCTS TAXATION PROPOSAL

In 1997 the Commission presented a new comprehensive Energy Products Taxation Proposal[13]. While the 1992 CO2/energy tax proposal had primarily been an environmental baby, the

[11] European Commission (1990b): *Draft Communication on the Use of Economic and Fiscal Instruments in EC Environmental Policy*. DG XI for Environment, Nuclear Safety and Civil Protection.

[12] This i.e. meant the introduction of fiscal neutrality as a guiding principle for the implementation of the tax. Second, the base of the tax had to be split between 50% on the CO2 content and 50% on the energy content of the fuels. This in order to avoid some of the disproportionate advantages to CO2-free nuclear energy that would have been the result of a pure CO2-tax. Thirdly, the competitiveness of energy intensive companies on global markets had to be safeguarded. This through exemptions for companies exposed to international competition and, following pressures from industrial lobby groups, the adoption of a conditionally clause, making the adoption of the proposal conditional on the adoption of similar measures by the main OECD partners Japan and the USA.

[13] Com (1997) 30 of 12.03.1997.

energy taxation proposal was born more as an internal market and taxation one. The aim was now no longer to introduce a new totally harmonised EU CO2/energy tax, but, more pragmatically, to extend and improve the existing framework for the Member State taxation of mineral oils to cover all energy products sold on the Internal Market. The proposal was still ambitious however.

The rates

The Commission proposal suggested a considerable increase of existing minimum rates on mineral oils, the introduction of new minimum rates on coal, natural gas and electricity and finally plans for the fixation of considerable step-wise increases in all the minimum rates until 2002 (see annex A).

The new minimum levels of taxation was going to enhance the room of manoeuvrability for Member States wanting to tax energy products for environmental purposes and use the revenues to lower labour taxes. This by working towards solving the problem of harmful tax competition, where lower or zero energy tax rates in one Member State give rise to the relocation of consumption and production, and thereby the loss of tax revenues and business in another Member State with higher tax levels.

In order to discourage Member States from increasing overall tax revenues the proposal suggested using the extra revenues generated through the energy tax to reduce taxes and social security charges on labour in order to help boost employment. Both the rates and the structure were now to be included in one directive.

The structure

A new structure was proposed, including an extended tax base and modified rules for the application of exemptions or reduced rates. All energy products (mineral oils, coal, gas and electricity) were now to be covered by the EU framework, while Member States were to be provided with more flexibility, permitting the introduction of energy tax policies tailored to national requirements.

The base

The energy tax proposal defined a comprehensive tax base. This included an extended number of mineral oil products, natural gas, coal/lignite, as well as any energy product which in any conceivable way could be used as motor or as a heating fuel, including biofuels, wood and peat, within the scope of the EU framework. Besides the listed products, any product used as motor or heating fuel, or as an additive or extender in such fuel, was also going to be taxed as motor or heating fuel.

Facultative exemption and reduction possibilities

In order to increase flexibility it was proposed to allow Member States to apply differentiated tax rates according to the use or quality of an energy product without prior Council authorisation, as long as minimum rates were observed. This option could be used to promote environmentally beneficial uses or product qualities.

It was also proposed to allow Member States to grant certain exemptions to energy intensive companies, in order to safeguard international competitiveness. While such exemptions were obviously somewhat negative seen from an ideal environmental point of view, they were nevertheless widely accepted as a necessary precaution to secure against a dislocation of Europe’s heavy industries to third countries.

Environmentally beneficial could be seen a redesign of the list of facultative total or partial exemptions in the directive to cover only activities that should be encouraged for environmental and energy efficiency reasons. This involved removing the exemption possibilities for fuels used in dredging operations in navigable sea waters and in ports, in the field of the manufacture, development, testing and maintenance of aircraft and ships and finally in agricultural and horticultural works and in forestry

and inland fisheries[14]. The facultative exemption for energy products used in power and heat production was furthermore proposed limited to heat generated during electricity production. Biofuels, renewable energy and hydro-power was finally added to the exemption list, together with natural gas in Member States whose gas market is in the process of actual development.

Mandatory exemptions

As environmentally positive could also be seen a limitation of the mandatory exemption for air navigation, making it possible for Member States to tax fuel used for domestic air flight or between Member States that conclude a bilateral agreement.

As environmentally negative could on the other hand be seen an extension of existing mandatory exemptions for mineral oils used for other purposes than heating and motor fuels and for energy products used in the production of energy products[15].

Negative could also be seen an application of the destination principle to the taxation of electricity, taxing the output of electricity production, while mandatory exempting the taxation of inputs, being the fuels used in the production of electricity. With this it would e.g. not be possible to apply a CO2-tax on energy products used in electricity production, in order to promote the use of biomasse in electricity generation

Air navigation

In a 1996 review of the aircraft fuel exemption, the Commission recommended that excise duties on mineral oils should be extended to aviation kerosene as soon as the international legal situation would allow the Community to levy such a tax on all carriers, including those from third countries. It was however not seen as practicable or desirable for the Community as a whole to introduce taxation of aircraft fuel targeting only intra-Community flights done by Community air carriers[16].

Based on this recommendation, the energy tax proposal did not cover fuel used for intra-Community air travel under the minimum tax rates, leaving it instead up to Member States themselves whether they would tax aviation fuel used for domestic air flight or between Member States, on the basis of bilateral agreements. However, energy products supplied as fuel for commercial aircrafts was going to be covered by the minimum tax rates, as soon as such products no longer had to be exempted under international obligations.

Dual-use

With the energy tax proposal it was now suggested that all energy products (mineral oils, natural gas, coal and electricity) used for purposes other than as motor fuels or for heating purposes should be mandatory exempted. In this regard it was further specified that heating purposes should not include energy products used principally for the purposes of chemical reduction, and in metallurgical and electrolytic processes, and that Member States should also exempt electricity used principally for the purposes of chemical reduction, and in metallurgical and electrolytic processes.

Behind these rather technical definitions lay a considerable extension of the existing mandatory exemption for the “non-fuel use” of mineral oils to what would in practice cover all so called “dual uses”, where mineral oils, natural gas, coal or electricity are used principally for purposes other than heating or as motor fuels. This meant the inclusion of energy products used for heating purposes under the exemption, as long as the principal purpose of the overall process involved the use of the energy product as a raw material. Or in other words, it meant a mandatory tax exemption of a considerable

[14] Fuels used in agricultural and horticultural works and in forestry and inland fisheries were proposed covered by the special low minimum rates for certain industrial and commercial purposes (see above).

[15] It played a lesser role when it came to the exemption for fuels used for air and sea navigation, as these fuels usually consist of mineral oils (except for e.g. coal used in steam boats).

[16] COM (96) 549 final.

part of the energy products consumed by large parts of Europe's heavy, most energy intensive, industries (including e.g. plastics, steel, alumnia, chemicals).

With an extension of the "non-fuel use" mandatory exemption to cover "dual uses", the EU energy tax framework would better reflect what was in fact the general trend of practice in Member States[17]. A basic rationale, generally advanced by Member States, behind the use of the wider interpretation of "non-fuel use" to cover "dual use" as well are the administrative difficulties of distinguishing between the use of energy products as heating fuel and as a raw material in the process[18].

Energy products used to produce energy products

The energy tax proposal furthermore suggested to mandatory exempt energy products (mineral oils, natural gas, coal) used to produce energy products. This constituted a considerable extension of the existing exemption for mineral oils used in the production of mineral oils.

While avoiding situations of double taxation that arise with the taxation of both the input and the output side of energy production, the environmental drawback of preventing Member States from providing energy producers with tax incentives for increased energy conservation would also be considerably enlarged.

Output taxation of electricity

The energy tax proposal also suggested to apply the destination principle to electricity taxation by introducing a mandatory exemption for energy products used to produce electricity and heat generated during its production. Member State should however, for environmental reasons, be allowed to tax these products anyway.

Applying the destination principle to electricity taxation has administrative advantages in terms of allowing for the differentiation of tax rates according to consumption (e.g. business and households) and border adjustment, applying the tax to electricity imports and lifting it of exports. The environmental draw back is that it does not directly allow for a tax differentiation according to the environmental quality of fuels used to produce the electricity. In an effort to remedy this, it was proposed to allow Member States to tax these products anyway, as long as the input taxes were not to be taken into account for the purpose of satisfying the minimum level.

COUNCIL NEGOTIATIONS (1. ROUND)

In spite of the new more pragmatic approach taken to the area of energy taxation it was still going to take more than six years of marathon negotiations and a considerably watered down directive text, before the Council was finally able to adopt a new energy tax directive under the Italian Presidency in the second half of 2003.

Principled opposition in Council

From the beginning the proposal was principally rejected by the Cohesion countries Spain, Portugal, Greece and Ireland, all voicing strong concerns about its potentially adverse eco-

[17] In December 1994 a considerable step had already been taken in the direction of accepting the national practices of exempting "dual use", with an amendment to the mineral oil structures directive, including the use of mineral oils used for heating purposes in the manufacturing of steel products under the mandatory exemption for "non-fuel use". The amendment was designed as a mandatory exemption from the general rule to tax mineral oils used for heating purposes for "*mineral oils injected into blast furnaces for the purposes of chemical reduction as an addition to the coke used as the principal fuel*".

[18] In the failed 1992 CO2/energy tax proposal the solution to this problem was simply to tax non-fuel use as well.

nomic effects, in terms of straining the competitiveness of heavy industries, creating inflationary pressures and unfairly burdening low-income groups.

These concerns persisted in spite of studies undertaken by the Commission in preparation of the proposal, showing how the impact on GDP would be marginally positive (0,02 to 0,2 %), while at the same time leading to the net creation of jobs (155000 to 457000). The studies also showed that the effect on consumer prices would be very limited while emissions of CO2 and other gases would fall by 0,5 to 1,6 %. The study furthermore pointed out that some energy-intensive companies may had to pay higher taxes, but that if the energy tax revenues were recycled back into the economy in the way suggested by the Commission proposal, production costs would be reduced across the board. The global reduction in production costs meant that the proposal would only present a limited loss of competitiveness for a few industrial sectors (mainly ferrous and non ferrous metals and gas distribution)[19].

A German compromise proposal

With plans for raising energy taxes (on motor fuels, light heating oils, natural gas and electricity) as part of an overall ecological reform of its national tax system, the German Presidency, in first half of 1999, carried high interests in advancing the energy tax directive. This was especially in terms of securing a raise in the minimum taxation of the border trade sensitive motor fuels diesel and petrol. Germany was not however particularly interested in a new minimum rate on coal. In Germany coal is obtained and used for electricity and heat production and for heating purposes in heavy industrial processes. Coal taxation was therefore, for reasons of employment and international competitiveness, not included in the German ecological tax reform.

In the first half of 1999 the German Presidency presented a considerably watered down compromise proposal. The proposal operated with a zero rate on coal, low rates on natural gas and electricity and small increases in the mineral oil rates. Together with a postponement of the minimum rates introduction, a widening of possibilities for reducing the taxation of natural gas, a removal of a suggested schedule for future increases and finally transitional periods for Member States having difficulties in implementing the new rates, an attempt was made to get everyone on board. However, under the firm leadership of Spain, the Cohesion countries upheld a strong principled opposition to the very idea of introducing higher and new EU minimum energy taxes.

INTERMEZZO

Besides some discussions concerning a Commission Communication on the taxation of aviation fuel and a set of new Commission guidelines for the use of state aid for environmental protection, Council negotiations on energy taxation came more or less to a halt after the German Presidency. Their was no signs of movement in the position of the critical Member States and moreover, a full blown political crisis erupted within the area of diesel fuel taxation, an area that for some time had been the cause of tension between the major EU Member States.

Diesel fuel crisis

Fuel tourism

In the late 1990ies Western European road haulers were facing a combination of high international fuel prices and intensified competition especially from new low-price haulage providers

[19] Boeshertz, D. (2004) "The EU Energy Tax Directive of 2003. Competitiveness and State aid issues in the political negotiations", Taxud/C-4.

from Eastern Europe. The world oil price had almost quadrupled within 18 months, rising from 9 USD/barrel by the end of 1998 to 35 USD/barrel by mid 2000 and up to 70 USD/barrel by August 2005. Such market pressures made it economically worthwhile for haulers to exploit variations in national diesel fuel tax rates by filling up their lorries in Member States with the lowest excise duty rates[20]. This so-called "fuel tourism" is made possible by the huge capacity of tanks in modern lorries, allowing them to cover between 1500 and 3000 kilometres on one fill.

Besides the overall environmental and transport problems of having heavy lorries travelling extra mileage with the sole purpose of filling their tanks at the lowest cost, "fuel tourism" also raised important fiscal issues. On the one side, high-tax Member States like Germany, Italy and France, who were experiencing a considerable loss in tax revenues and fuel business as an effect of the practice, would regularly call upon the Council to introduce higher minimum taxes, in order to counter this, in their eyes, harmful tax competition. On the other side, the low-tax Member States benefiting from the border trade, such as Spain and Luxembourg, would strongly defend their right to set their own levels of diesel taxation.

Fuel protest

Besides engaging in "fuel tourism", haulers reacted to the increased market pressures of the late 1990s by raising demands on their governments for various aid schemes, among which cuts in fuel taxation were usually high on the wish list. In January 2000 haulers in France chose to bolster such demands with physical blockades of all main highways, ports and border crossings. This led to a government promise for a national commercial diesel fuel tax cut. The word of the apparent success of the French haulers spread like a wildfire into neighbouring countries, all culminating with a number of dramatic fuel protests in most of the EU Member States in September 2000. While most Member States managed to find other solutions (mainly in the form of other types of aid schemes), Italy and the Netherlands were besides France eventually the only ones that gave in to the haulers demands for tax relief, by providing some relatively modest temporary reductions in diesel fuel rates.

When the French government gave in to the fuel tax protests of its national haulers it was perceived as a stab in the back in Germany. Along with the other Ministers of the ECOFIN Council, the French Finance Minister had on several occasions solemnly declared that it would reject any demands for fuel tax cuts, in account of their detrimental effects on both competition, state revenues and the environment. By giving in to its haulers anyway, France added considerable pressure to an already strained German government in the diesel tax question. In Paris the viewpoint was different. Here Germany was seen to be overreacting and lacking understanding of the difficult position of France, with its long border to the low diesel tax country Spain.

The French view did not alter the German sentiment. It was therefore only under loud protests, and after having charged a high price in the form of the adoption of another Directive which allowed for a prolongation of German coal subsidies, that Germany in March 2001, along with the rest of the Council, accepted to authorise the French, Italian and Dutch diesel reductions, for a limited period until the end of 2002.

Commission Communication on Aviation fuel

Under the Finnish Presidency in the second half of 2000 the Council Working Group on Fiscal Affairs managed to discuss the issue of aviation fuel. This was on the basis of a Commission Communication on aviation fuel, comprising a comprehensive study conducted by an independent consultancy[21].

The results of this study confirmed the conclusions, which the Commission drew in its 1996 report on this question. Principally for economic reasons, it would not be practicable or desirable

[20] In 2002 the Member State excise duty rates on diesel fuel was listed by the Commission in EUR/1000 litres as follows: UK:742, D:440, I:403, F:376, DK:370, NL:345, S:337, SF:305, IE:302, E:245, B:290, A:282, P:272, L:253, EL:245. Proposal for Council Directive amending Directive 92/81/EEC and Directive 92/82/EEC to introduce special tax arrangements for diesel fuel used for commercial purposes and to align the excise duties on petrol and diesel fuel. 2002/0191 (CNS).

[21] COM (2000) 110 final.

for the Community as a whole to introduce taxation of aircraft fuel targeting exclusively intra-Community flights operated by Community air carriers at the present time. On the other hand, the study equally confirmed that there would be significantly higher environmental benefits from the introduction of kerosene taxation targeting all operations from Community airports. The Commission therefore recommended that the Council, besides adopting the Commission energy tax proposal permitting Member States to levy tax on aviation fuel used on national flights, or by bilateral agreement, intra-Community movements, intensify their work together with the Commission within the ICAO framework for the introduction of taxation on aviation fuel and other instruments with similar effects. All Member States, at the time, seemed to support these Communication conclusions.

The application of the Treaty rules on state aid

Increased state aid control

During the late 1990s an important issue concerning the Commission application of the Treaty rules within the area of energy and environmental taxation started to appear still more regularly on the Council agenda[22]. The Commission's DG Competition had at some point started to take a more active interest in the Member State use of energy tax exemptions and reductions in favour of certain firms or sectors and in whether these were in accordance with the EC Treaty rules on state aid[23].

The newfound interest of the Commission DG Competition officials raised concerns among many Member States about the legal certainty of their existing energy tax systems, demanding flexibility in the Commission application of the state aid rules. This in order to ensure the necessary room of manoeuvrability to design energy and environmental tax systems in accordance with particular national requirements, especially the need to safeguard the international competitiveness of energy intensive business sectors when Member States went beyond what was required by the Community minimum[24]. Some Member States were furthermore concerned that they would not be allowed to provide environmentally beneficial tax incentives for renewable energies and combined power and heat production.

Guidelines for the use of state aid for environmental protection

After intensive discussions with the Member States, the Commission adopted a revised set of guidelines for the use of state aid for environmental protection in 2001 that to some extent heeded the concerns of Member States[25]. The aim was to familiarise Member States and firms with the

[22] According to Article 87 of the EC Treaty state aid granted by a Member State or through State resources, which distorts or threatens to distort competition by favouring certain firms or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market. It has been established by EC case law that the granting of tax concessions entails a loss of state resources and thereby a potential state aid, within the meaning of the Treaty. The Treaty allows certain exceptions to the ban on state aid, in cases where the proposed aid schemes may have a beneficial impact in overall Union terms. It is the European Commission that decides whether or not an aid, in this way, is compatible with the Common Market. If it is incompatible, the Commission has the power to require that the aid be repaid by recipients to the public authorities which granted it. In order to clarify its State aid policy, the Commission has over the years adopted a number of guidelines covering a range of specific areas. The guidelines most relevant for the area of energy taxation are the Community guidelines for the use of State aid for environmental protection (2001/C 37/03).

[23] According to Commission sources the DG Competition interest in energy taxation and state aid was apparently first instigated by an informal investigation into an existing energy tax derogation for alumina production in Ireland. Ireland had obtained the Council's permission for the derogation according to the procedure laid down in article 8.4 of the mineral oils directive. This, however had worked as something of a thorn in the flesh of officials in the Commissions DG for Taxation, who felt that the derogation was clearly distorting competition, favouring Irish alumina producers to the detriment of other heavy industries at home and abroad. DG for Competition was therefore asked by the Commission tax officials for an opinion. As it turned out the derogation was illegal according to state aid rules and had to be removed.

[24] In the draft political compromise of the German Presidency it was noted that "It will be crucial for Member States to evaluate the limits resulting from Community state aid rules for national provisions for reduced rates or exemptions for certain sectors and to be allowed to make use of the resulting freedom of manoeuvre in a flexible way: this applies particularly when, for environmental and/or health policy reasons, Member States wish to go beyond a Community minimum taxation. The Council considers that there is an urgent need to solve the existing problems as to the interpretation and application of Community state aid rules (Council doc 7738/99 Fisc 101 of 05.05.1999).

[25] OJ C 37 of 03.02.2001.

criteria that the Commission were going to apply in deciding whether or not indirect tax measures planned by Member States were compatible with the common market. Particular consideration would in this regard be given to the effects that the aid may have in terms of sustainable development and application of the 'polluter pays' principle.

In the guidelines, the Commission took the view that exemptions from or reductions in environmental taxation granted to firms in order to avoid placing them in a difficult competitive situation may constitute state aid. However, it was also stated that the adverse effects of the aid could be offset by the positive effects of adopting such taxes and that if such exemptions were necessary to ensure the adoption or continued application of taxes applicable to all products, they would be acceptable, subject to certain conditions and for a limited period of time, lasting for up to 10 years. Member States would thereafter remain free to re-notify the measures in question to the Commission. The Commission further took the view that where measures to promote renewable sources of energy and the combined production of electric power and heat constitute State aid, they would also be acceptable subject to certain conditions.

Case law

Further clarification of the area of state aid was provided by an ECJ ruling also from 2001, involving the question of whether an Austrian energy tax rebate, covering only manufacturing industries, constituted a state aid within the meaning of the Treaty (*Henvisning*). According to the Austrian government, the measure should not be considered a state aid, since it was based on objectively defined criteria and benefited a very large number of undertakings. It therefore didn't have the selective nature that would trigger application of the state aid rules.

The ECJ ruling went against the Austrian government. First, it clarified that an energy tax rebate only constitutes a state aid if it displays a degree of selectivity, meaning that it favours certain undertakings or the production of certain goods over others. Second it made clear that a measure, although conferring an advantage on its recipient, does not fulfil the condition of selectivity if it is justified by the nature or general scheme of the system of which it is part. Finally, it ruled that the Austrian tax rebate was not justified by the nature or general scheme of the energy tax system, why it had to be considered a state aid. To substantiate this it was argued that the ecological considerations underlying the national legislation at issue did not justify treating the energy consumption of service sector companies differently than the consumption of such energy by undertakings manufacturing goods. Energy consumption by each of those sectors is equally damaging to the environment.

COUNCIL NEGOTIATIONS (2. ROUND)

Kick-starting the process

Having lain dormant for some time, the energy tax dossier was awoken by the Swedish Presidency in the first half of 2001. Carrying a high environmental profile and having a long time national tradition of using energy taxes for both fiscal and environmental purposes, Sweden had great interests both in raising minimum rates and in improving the legal framework for the use of energy taxes in the EU. In order to get the negotiations going, the Swedish Presidency pursued a strategy whereby the council would start out by focusing only on the structural aspects of the directive, leaving the more controversial issue of minimum tax rates to a later date.

While successfully kick-starting the negotiation process, the Swedish strategy also revealed the persistence of political differences. There was, however, some indication, that a softening of the positions could be pending. This was when a Swedish Presidency statement to the ECOFIN, saying that the Council agreed on the necessity of introducing a suitable framework for the taxation of energy at the EU level and for the creation of a common energy market, was only rejected by the United Kingdom.

Besides the continuing differences on the political level, many more technical difficulties were also exposed during the Swedish Presidency. Difficulties that had to be solved before even the majority of Member States that was politically in favour of the directive would be able to agree. These included e.g. questions about how to define and tax energy intensive companies, the use of tax differentials and the definition and scope of the exemption and reduction possibilities of the directive.

Some agreement did however seem to be found on other issues, including the application of the general principle of out-put taxation to electricity taxation and that Member States should be able to exempt energy products and electricity used in combined power/heat generation, as well as electricity produced from combined heat and power generation. In this regard some Member States raised demands that only environmentally efficient generation plants should be eligible for the exemptions.

Enhanced co-operation

In view of the continued political differences, the Commission adopted the view in a May 2001 communication on EU tax policy that "enhanced co-operation" could provide a way forward in the area of environmental and energy taxation[26].

"Enhanced co-operation" is a mechanism that was established in 1997 with the Treaty of Amsterdam, when it had become clear once again that Member States were not willing to give up their veto in tax matters. The mechanism gives a group of at least 8 Member States, under certain restrictions, the right to pursue closer co-operation within specific areas.

The incoming Belgian Presidency in the second half of 2001 followed up the view of the Commission, announcing that if unanimous agreement was not found at the December European Council summit in Laeken enhanced co-operation on energy taxation could appear as a serious option. On this basis Belgium continued the strategy laid out by the Swedish Presidency, focusing on the structural aspects of the directive while leaving the controversial question of rates to later[27].

Besides an overall agreement on the need to provide exemption possibilities for electricity from renewable sources of energy, no significant progress occurred under the Belgian Presidency. Instead new problems arose, including the issue of state aid, with several Member States now expressing serious doubt about the legal certainty of the exemption and reduction possibilities that were to be provided by the Directive.

Attempting to establish some common ground the Presidency drafted a set of Council conclusions, containing some overall principles for the further work. But, when December came there was no Council agreement to be found on the Presidency conclusions. While the prospects of finding agreement on the energy tax dossier now seemed somewhat bleak, there were on the other hand also some real indications that the positions of the opponents really were somehow on the move.

In marked contrast to its previous principled opposition to the very idea of new minimum taxation, the upcoming Council President Spain was now linking a possible solution of the energy tax

[26] COM (2001) "Tax policy in the European Union - Priorities for the year ahead", COM (2001) 260 of 23.05.2001.

[27] The main discussion in the working group during the Belgian Presidency concerned the ramifications of an ECJ judgement from 1996 dealing with provisions in the Finish energy tax system, providing electricity produced domestically from renewable energy sources with a lower tax rate than imported electricity (Case C-213/96, Outokumpu Oy vs. the Finish Government). Imported electricity was charged an average between the low rate for electricity from renewable energy sources and the standard rate for electricity from non-renewable energy sources, based on the reasoning that it is not possible to determine whether imported electricity is produced from renewable or non-renewable energy sources. In spite of this the Court ruled that Article 95 of the Treaty precludes an excise duty from being levied on electricity of domestic origin, at rates which vary according to its method of production, while being levied on imported electricity, whatever its method of production, at a flat rate which, although lower than the highest rate applicable to electricity of domestic origin, leads, if only in certain cases, to higher taxation being imposed on imported electricity. On the basis of the working group discussion, the Member States generally agreed that the directive should still allow Member States to apply tax reductions in favour of electricity produced from renewable energy sources, in spite of the border problem raised by the case law. For a possible solution to the problem, the group looked ahead to an upcoming directive from the Energy Council on the promotion of electricity from renewable energy sources, that would contain a system providing electricity from renewable sources with a guarantee of origin. Such a guarantee might work as a basis for applying the same low rates to both nationally produced and imported electricity from renewable energy sources.

issue with a solution within the area of energy liberalisation. This strategy was supported by Portugal. Another of the strong opponents, Ireland, also seemed to have come out of the closet, now placing strong support behind a long-term British demand for a possibility in the directive to fully exempt household energy consumption. When it came to enhanced co-operation, the idea was only really supported by a couple of Member States and it was outright rejected by the Spanish and Portuguese Finance Ministers. Instead the ECOFIN concluded, that the search for an agreement between all 15 Member States should remain a priority, at least until the end of the Danish Presidency in December 2002.

Eastern enlargement

December 2002 was no arbitrary date. This was the date when the Community planned to conclude its negotiations for the accession of ten new countries in the EU, most from Central and Eastern Europe. The upcoming Eastern Enlargement seemed to provide the energy tax negotiations with a new essential driver. The perspective of having to compete on the Internal Market with ten new Member States, most of these with low or no energy taxes in place, seemed to create new determination in the Council to find a solution within the energy tax area. This among the traditional high tax proponents of the directive, but also among the most reluctant Member States Spain, Portugal, Greece and Ireland, who with enlargement would suddenly jump from being the low-tax members to being the middle-tax members of the club. As it was hard to imagine a future EU of 25 finding an unanimous agreement on the energy products tax directive, it seemed to be now or never.

The Spanish Presidency

The shift in Spanish sentiment became clear to everyone when the Spanish Presidency announced in its Presidency Programme: “that it would promote the discussion on the harmonisation of energy taxation in parallel with the establishment of a genuine European energy market”. The programme furthermore stated that: “the Council would begin analysing taxation rates and continue examining tax structures as well as addressing the taxation system for diesel used in road transport”.

New Spanish position

Besides securing higher minimum rates before Enlargement, Spain’s long held interest in promoting the liberalisation of European energy markets, together with a specific wish for higher flexibility in the treatment of diesel for road transport also helped to explain the new found Spanish interest in the energy tax dossier.

As a frontrunner of national energy liberalisation, Spain had been struggling for some time to achieve improved access to the notoriously closed energy markets of neighbouring France. One of the top priorities of the upcoming Spanish Presidency was therefore to secure the adoption of two directives on the further opening and liberalisation of the EU electricity and gas markets, that at the time was being negotiated by the Council of Energy Ministers. By linking a solution in the area of energy taxation with a solution in the area of energy liberalisation, Spain apparently hoped to push a trade-of with France, who was among the Member States with high levels of national energy taxation and therefore interests in the adoption of the energy tax directive. Besides Portugal, Spain found good support for this strategy in Britain, another member strongly in favour of European energy liberalisation.

Spain was furthermore, together with countries like Portugal, Greece, Luxembourg, Italy and Ireland, looking to secure a possibility in a new energy tax directive that would allow Member States to differentiate between diesel used for respectively private and professional road transport, without prior Council authorisation. This was because it wanted to be able to increase its national tax on private road diesel, making it correspond better with the rate for ordinary gasoline, without having to raise the rate for commercial diesel, and thereby hurt the competitiveness of its road haulers[28].

[28] All Member States, except the United Kingdom, tax petrol more heavily than diesel fuel.

Political progress

With a converted Spain at the helm of the energy tax negotiations, they finally started to see real political progress. This was manifested at the European Council meeting in Barcelona in March 2002, were the Council was urged to adopt as early as possible in 2002 the pending proposals for the final stage of the market opening of electricity and gas and “in parallel with the agreement on the opening of the energy markets, to reach an agreement on the adoption of the energy tax directive by December 2002, bearing in mind the needs of professionals in the road-haulage industry”.

On the basis of this unambiguous call for agreement from the highest political authority of the Community, the Spanish Presidency proposed a set of political guidelines for the further work of the Council Working Group. The Spanish guidelines drew in large part on the 1999 German compromise proposal. A few controversial elements were added however, including i.e. a small positive rate on coal, an addition of mineralogical processes to the concept of dual use and a set of special arrangements for the professional use of diesel.

While the guidelines were generally unacceptable to several of the Ministers in the ECOFIN, a sense of agreement did arise around some elements during the Spanish Presidency, including, most importantly, the level of minimum rates (including the rate on coal). Left for the upcoming Danish Presidency to solve before the December 2002 deadline was however still a considerable number of difficult problems.

The Danish Presidency

During the 1990ies Denmark had played a role as frontrunner in the use of national environmental taxation, strongly encouraging it’s EU partners to follow suit. This policy changed decisively with a shift in Danish Government power from centre-left to right in November 2001. Observing “green” taxes as “red” taxes, and having won the election partly on the promise of securing a strict freeze in the growth of any types of taxation, the new Danish government choose a considerably lower profile on environmental taxation for its term as EU President in the second half of 2002.

While showing less political enthusiasm for the energy tax initiative, the Danish Presidency was still committed to reaching the December 2002 deadline set in Barcelona. With this in mind, a pragmatic strategy was chosen. Using the guidelines presented by the previous Spanish Presidency as a basis, the Danish Presidency would be open for any Member State concerns or wishes, as long as these could somehow be fitted into an overall compromise that would secure a December agreement. Carrying valuable experiences from the use of national energy taxation, the Danish Presidency would be particularly minded towards solving the broad range of technical difficulties, which until now had been left over from previous Presidencies.

The size and scope of business reductions

Energy-intensive businesses

Since the beginning of the negotiation process all Member States had generally agreed that in spite of the environmental drawbacks, energy-intensive businesses should be eligible for tax reductions, in order to safeguard their international competitiveness.

However, a persistent problem had been how to define an energy intensive business. What should be the threshold for regarding one business as energy-intensive and another as non energy-intensive? Under the Spanish Presidency it had eventually been more or less settled that the threshold for energy-intensity should be fixed by the Council as a percentage rate of either “energy tax payable” in relation to “added value” or “purchases of energy products” in relation to “production value”.

On this basis, the Danish Presidency grew an ambition to establish a fully harmonised definition of an energy-intensive business, which would not vary as an effect of differences and changes in national energy tax rates or as an effect of fluctuations in international energy prices. With this

this aim, the Presidency suggested a definition based on a percentage rate of EU minimum tax payable in relation to either added value or production value. As for the fixing of the percentage rate, Member States were encouraged to go home and study their industrial structures, in order to determine which percentage rate would effectively cover the companies that they felt should be considered as energy-intensive and thereby entitled to energy tax reductions.

As it were, a large majority of Member States strongly rejected the Danish Presidency proposal, seeing it as an unbecoming violation of the basis for defining an energy intensive company that had been agreed upon during the Spanish Presidency.

Under the Danish Presidency the Council eventually settled on a much more flexible, but also less harmonised, definition of an “energy-intensive business” as a business entity where either the purchases of energy products and electricity amount to at least 3.0 percent of the production value or the national energy tax payable amounts to at least 0,5 % of the added value. It was added that, Member States could apply more restrictive concepts, including sales value, process and sector definitions.

Agreements, tradable permit schemes or equivalent arrangements

Having settled on the definition of an “energy-intensive business”, it was still an open question what size of reduction an energy-intensive business should be entitled to. The majority of Member States, who were not taxing energy intensive industries, preferred to be given a possibility to reduce below the new minimum levels, all the way down to zero. This wish were rejected by a minority of Member States with business energy taxation in place, observing it as being completely against one of the basic ideas of the directive, namely to create a more level playing field for businesses on the Internal Market, through the introduction of minimum rates and with these common incentives for energy conservation on the internal market.

In an effort to balance the wishes of Member States wanting to be able to exempt their energy intensive industries from energy taxation and Member States demanding more equal energy conservation incentives on the Internal market, the Danish Presidency proposed a compromise whereby Member States could go down to zero for energy intensive businesses, but only in return for the conclusion of agreements, tradable permit schemes or equivalent arrangements leading to the achievement of environmental objectives or increased energy efficiency, broadly equivalent to what would have been achieved if the minimum rates had been observed.

With Germany insisting that Member States should under all circumstances respect the minimum rates and linking a possible compromise on this issue to a satisfactory solution of the most controversial issue of professional diesel, the Council was not able to agree on the Danish Presidency proposal during the Danish Presidency.

Non-energy-intensive businesses

Besides demanding possibilities to go below the new minimum levels for energy intensive businesses, some Member States furthermore insisted on having a possibility to apply reductions on non-energy intensive businesses as well, even going below the new minimum rates if necessary.

This demand was eventually also heeded in the Danish Presidency compromise proposal with a possibility to go down to the minimum for non-energy-intensive businesses where agreements are concluded, or where tradable permit schemes or equivalent arrangements are implemented, as far as they lead to the achievement of environmental protection objectives or to improvements in energy efficiency.

A possibility was also given to go 50 percent below the minimum, under the slightly stricter condition, that the non-energy-intensive businesses enter into agreements, tradable permit schemes or equivalent arrangements leading to the achievement of environmental objectives or increased energy efficiency, broadly equivalent to what would have been achieved if the minimum rates had been observed.

Several Member States furthermore saw a need to protect businesses in general from the effects of the new minimum rates on coal, natural gas and electricity. The Danish Presidency therefore also proposed an overall 50 percent lower minimum rate for the “business use” of these three energy types.

With Germany again insisting that Member States should under all circumstances respect the minimum rates and linking any compromise on this issue to a satisfactory solution of the most controversial issue of professional diesel, the Council was not able to agree on the Danish Presidency proposal during the Danish Presidency.

Tax differentiations

Quality

It was relatively easy for Member States to agree on the need to allow differentiations of national rates according to the quality of energy products, a provision designed to facilitate the promotion of products of a higher environmental quality.

Use

The proposal to allow differentiations according to use needed more deliberation. On one side where Member States like Spain, Portugal, Luxembourg and Ireland wanting an open provision, leaving Member States with flexibility in the use of differentiations. Together with Italy these countries were particularly hoping to apply differentiated rates between commercial and non-commercial use of diesel for road transport. On the other side were most other Member States insisting on the need to keep the existing procedure, whereby the application of differentiations required prior Council authorisation, at least when it came to the area of road transport.

Choosing to propose a separate set of special arrangements for the treatment of diesel for road transport (see below), the Spanish Presidency had eventually suggested a list of concrete uses of a public service or social nature for which Member States should be allowed to apply differentiated rates without prior Council authorisation. The uses eventually agreed upon under the Danish Presidency were local public passenger transport (including taxis), waste collection, armed forces and public administration, disabled people and ambulances.

Business and non-business

During negotiations it became clear that there was a need for an additional provision to allow differentiations between business and non-business use. This need had arisen along with the fulfilment of Member State wishes for a possibility to apply a reduced rate for non energy-intensive businesses and lower minimum rates for “business use” (see above). It was furthermore called for in order to facilitate an exemption for households and/or charitable organisations (see below). As far as Member States could agree on these other issues they could also agree on providing a possibility to differentiate between business and non-business use.

Quantitative consumption

A rule allowing for differentiated rates when the differentiated rates depend on quantitative consumption levels for electricity and energy products used for heating products was finally also adopted. This provision was entered on behalf of the Dutch government, which did not feel sure that its particular national method of reducing for energy intensive businesses would be covered by the other provisions of the directive. No Member State objected to adding this provision.

Various issues

Business use and the business entity

In order to facilitate the application of lower rates on “business use”, it was necessary to define what “business use” was. Finding inspiration in the Sixth VAT directive, and following deliberations in the Council Working Group, the Danish Presidency eventually managed to find Council agree-

ment on defining “business use” as use by a business entity, which independently carries out, in any place, the supply of goods and services, whatever the purpose or results of such economic activities.

Economic activities were further specified as comprising all activities of producers, traders and persons supplying services including mining and agricultural activities of the professions. Excluded from the definition of “business use”, were state, regional or local authorities and other public bodies, unless they engage in business activities.

Important to notice is how Member States were allowed to limit the scope of reduced taxation for “business use”, thereby providing a large amount of flexibility in how to define “business use” in practice.

To secure against tax planning mainly in connection with the definition of an energy-intensive business eligible for special reductions, a “business entity” was furthermore suggested as an entity that cannot be considered as smaller than a part of an enterprise or a legal body that from an organisational point of view constitutes an independent business, that is to say an entity capable of functioning by its own means[29].

Households and charitable organisations

With “fuel poverty” (of low income groups living in poorly isolated housing) being a central concern in the design of national environmental tax policies, the United Kingdom had all along insisted on a possibility to exempt energy products consumed by households, as a precondition for its overall accept of the directive. Britain also wanted to be able to exempt charitable organisations.

Supported by Ireland, the British demand was eventually heeded by the Council. In formulating the provision, it became a problem how to delimit charitable organisations for the exemption. The solution eventually was to allow Member States to exempt all non-businesses. This in effect meant a possibility to exempt not only households and charitable organisations, but also all state, regional and local public authorities or other public bodies.

Energy products used to produce energy products

An issue which had not been discussed before the Danish Presidency was the proposal to extent the existing mandatory exemption for mineral oils used in the production of mineral oils to all energy types, so that all energy products used in the production of all energy products would be exempted, by way of not considering the consumption of such energy products a chargeable event in the directive.

When taken up by the Danish Presidency, the only Member State that seemed to have a problem with the Commission proposal was Denmark itself. Like it had been the case with dual use and mineralogical processes, the extension of this exemption would also entail the removal of energy taxes on certain industrial processes in Denmark, to the detriment of both the environment and Danish state revenues.

In order to limit the problem, the Danish Presidency proposed to narrow down the exemption to cover only energy products, which are produced by the energy-producing establishment itself. However, this solution was unacceptable to other Member States, who wanted to make sure that they could exempt the consumption of all energy products, especially electricity, used in the production of energy products.

As a compromise it was decided first that energy products that are consumed within the curtilage of an establishment producing energy products should not be considered as a chargeable

[29] The definition of a “business entity” was entered on suggestion by the Danish Presidency who years before had experienced some problems with its national CO2-tax. The problem had been that companies were changing their company organisations in order to meet the threshold for being considered an energy intensive business liable for energy tax reductions. The way to do that was to separate the labour intensive units from the energy intensive units. On one occasion a company went so fare as wanting to register a single machine as an independent company unit.

event, giving rise to taxation, if the consumption consists of energy products produced within the curtilage of the establishment. Second Member States may also consider the consumption of electricity and other energy products not produced within the curtilage of such an establishment, as not giving rise to a chargeable event. Finally it was decided that where the consumption is for purposes not related to the production of energy products and in particular for the propulsion of vehicles, this shall be considered a chargeable event, giving rise to taxation.

Combined power and heat generation

During the Swedish Presidency it had been agreed to provide some sort of facultative exemption possibility for energy products used to produce heat in combined power and heat production, and for electricity generated from power and heat.

For some time the United Kingdom had however wished that such exemptions should only be granted to environmentally efficient power/heat generation plants. Germany had supported this demand for a period. But some time during the Danish Presidency Germany shifted its position to demand instead that there should be no restrictions on the exemption for input fuels. Thus, the demand for environmental efficiency should only apply to the exemption for electricity generated from power/heat.

The final result reached under the Danish Presidency was that fuels used to produce heat in power/heat plants could be exempted freely, while electricity from power/heat generation could only be exempted if it came from an environmentally efficient power/heat plant. For some time the Council Working Group attempted to reach an agreement on how to define environmentally effective combined power/heat production. This effort was eventually abandoned, leaving it up to Member States themselves to define what should constitute an environmentally effective plant.

Air navigation

It was relatively easy for the Danish Presidency to ascertain agreement on the Commission proposal to allow Member States to tax fuel used for air and sea navigation nationally or between Member States that conclude a bilateral agreement.

The Presidency had furthermore counted on an easy ride when it came to the proposal that energy products supplied as fuel for commercial air crafts was going to be covered by the minimum tax rates, as soon as such products were no longer obliged to be exempted under international obligations. However, as it turned out, Spain and Ireland were far from willing to agree to this proposal. A statement to the Council minuets on aviation fuel therefore had to be formulated as follows:

“All delegations, with the exception of Ireland and Spain, and the Commission agree that as a matter of principle, and in the interest of a consistent tax system, commercial aircraft fuel should be taxed on the same basis as any other fuel. However, the question of competition with third countries needs to be taken into account and any distortion of competition with socio-economic implications has to be avoided. All delegations, with the exception of Ireland and Spain, and the Commission are of the view that an appropriate strategy would be to pursue the discussion on the matter with the ICAO and that when taxation of such products will be allowed at international level, the Council needs to decide, on the basis of a proposal from the commission, whether to abolish the exemption”.

Emissions trading

Since the fall of the 1992 CO2/energy tax proposal, one of the major initiatives keeping the officials in the Commission Environment Directorate busy had been the development of a EU-wide greenhouse gas (GHG) emissions trading scheme. The scheme was going to work as a central element in the effort to achieve the EU GHG reduction target of 8 % in 2008-12 compared to 1990 levels, in accordance with the internal EU burden sharing agreement. A proposal was presented in October 2001.

During the energy tax negotiations it was raised as a problem that some industries might become subject to both minimum energy taxation and emissions trading. In order to solve this problem

in time for the December deadline, it was hurriedly decided under the Danish Presidency to adopt a statement to the Council minutes saying that the Council will undertake to “positively examine tax measures, which will accompany the future implementation of a Community emission trading scheme, particularly in order to avoid cases of double taxation”.

The use of biofuels for road transport

In November 2001, during the Spanish Presidency, the Commission presented a new major initiative within the area of alternative fuels for road transport, which would turn into yet another difficult problem in the on-going energy tax negotiations.

In a Green paper on energy supply security from 2000 the Commission had introduced an objective to substitute 20 percent of fuels used in the road transport sector with alternative fuels by the year 2020[30]. This was done with the dual purpose of improving security of supply and reducing greenhouse gas emissions.

In the subsequent November 2001 Commission Communication on alternative fuels for road transportation a replacement of conventional diesel or gasoline with biodiesel or ethanol was identified as the most simple, and thereby least costly technology, to pursue at present (in comparison with e.g. natural gas and fuel cells). On this basis two concrete proposals for measures to promote the use of biofuels were presented[31].

The first proposal was for the Council of Transport Ministers, asking it to place a mandatory requirement on Member States to increase the proportion of biofuels blended in diesel and gasoline sold, starting with 2 percent in 2005 and increasing until reaching 5 percent in 2009. As a transport proposal this could be decided upon on the basis of qualified majority in the Council.

The second proposal was for the ECOFIN, asking it to support the first proposal by allowing Member States to apply differentiated tax rates in favour of biofuels. As a tax proposal this had to be accepted by all Member States in order to be adopted.

The problem presented to the energy tax negotiations by the Commission biofuels initiative was not in regards to the proposal to allow biofuel tax differentiation as such. A provision to allow for such a differentiation was already foreseen in the Commission energy tax proposal, and had furthermore all along been generally accepted by the Member States. The problem was in regards to the proposal for the introduction of mandatory biofuel levels in the supply of diesel and gasoline. This proposal was being rejected by a minority of mainly Nordic Member States, who felt that it at should be left up to the Member States themselves whether or not they would enforce a blending of biofuels into their national supplies of diesel and gasoline.

Pressing the minority in the Transport Council were a majority of Member States, who besides the environmental and fuel supply benefits of promoting biofuels were hoping to boost a promising biofuels industry, providing rural development and the maintenance of employment in the rural community. Facing a down vote in the Transport Council, the minority of Member States choose to use their veto in the ECOFIN Council instead, blocking the tax proposal for as long as the provisions of the transport proposal remained mandatory.

Drawing this nerve-raking standoff to the latest minuets, the majority eventually gave in, finding greater interest in applying tax reductions in favour of biofuels than in enforcing a EU wide blend of biofuels into regular fuels.

Under the Danish Presidency it was finally decided to incorporate the biofuels tax proposal into the energy tax directive as a new Article 16 and, in order to hold the majority to its promise, to enter

[30] Green Paper - Towards a European strategy for the security of energy supply COM/2000/0769 final.

[31] Commission Communication on alternative fuels for road transportation and on a set of measures to promote the use of biofuels, including proposal for a Directive on the promotion of the use of biofuels for transport and proposal for a Directive amending Directive 92/81/EEC with regard to the possibility of applying a reduced rate of excise duty on certain mineral oils containing biofuels and on biofuels COM(2001)547 final.

a legally somewhat peculiar provision, stating that if Member States should be required by Community law to comply with legally binding obligations to place in their markets a minimum proportion of biofuels, the reduction possibility for diesel fuel given in the energy tax directive shall cease to apply.

Agricultural and horticultural works, etc.

Another issue which had not been discussed before the Danish Presidency was the Commission proposal to remove fuels used in dredging operations in navigable sea waters and in ports, in the field of the manufacture, development, testing and maintenance of aircraft and ships and finally in agricultural and horticultural works and in forestry and inland fisheries from the list of facultative exemptions.

As it turned out a considerable number of Member States were not willing to give up these exemption possibilities, demanding that they were left as they were. While a majority of Member States would probably have preferred to follow the Commission proposal, only Germany found it worth while to struggle for, contending that as a minimum, agricultural and horticultural works and forestry and inland fisheries had to be covered by the lower minimum rates for industrial and commercial uses.

Eventually drawn in as a crucial issue for the establishment of an overall political agreement on the Directive, Germany was unwilling to back down. In an attempt to avoid that anyone lost face in the matter the Danish Presidency suggested a somewhat awkward construction of including agricultural and horticultural works and forestry and inland fisheries under both the special low minimum tax rates for commercial and industrial uses and the facultative exemptions, with the later provision of course being the only relevant one of the two[32]. With Germany linking a compromise on this issue to a satisfactory solution of the most controversial issue of professional diesel, the Council was not able to agree on this issue during the Danish Council Presidency.

The application of exemptions and reductions

Following the wishes of various Member States it was agreed under the Danish Presidency to provide a high degree of flexibility to the way Member States can give effect to the exemption or reductions in the level of taxation prescribed by the Energy Products Taxation Directive. It was decided that Member States should be able to provide exemptions and reductions either directly, by means of a differentiated rate or by refunding all or part of the amount of taxation.

Wood, peat and the output taxation of heat

Towards the end of the Danish Presidency it was decided to leave wood, peat and the output taxation of heat outside the scope of the directive. As wood and peat are biofuels Member States were already allowed to exempt them. The reason why they were left outside the directive anyway was practical, in order to make sure that they were not to be covered by the rules for movement and control of excise duty products. The output taxation of heat was left out on behave of Denmark, who wanted to make sure that such taxation would not later become interpreted as illegal.

Tax neutrality

In the Commission energy tax proposal it was stated in article one, that Member States, when implementing the directive, should endeavour to avoid any increase in their overall tax burden. In order to attain this objective Member States should endeavour, in particular, to reduce at the same time statutory charges on labour.

Feeling that the aim of tax neutrality, including the encouragement to reduce statutory charges on labour, was a bit too political to have in an actual article, the Danish Presidency suggested

[32] Article 8(2) and 15(3) in Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

to remove the sentence. Instead the Presidency asked the Council to rely on a wording about tax neutrality stated in a suggested revised set of directive recitals. The wording said, that the restructuring of the tax framework applicable to energy products should not result in an increase in the overall tax burden in Member States. It was furthermore stated that the implementation of the principle of tax neutrality will contribute to the restructuring and the modernisation of tax systems by encouraging behaviour conducive to greater protection of the environment and increased labour use. It was finally added, that the determination of the arrangements for ensuring tax neutrality is a matter for each Member State.

For several Member States, including particularly Spain and Ireland, the recital on tax neutrality was not acceptable. By leaving it out these Member States wanted to make it perfectly clear that it was left completely to the Member States themselves how to spend the revenues from the applicable energy taxes. Other Member States, including the Commission, on the other hand insisted on the recital, finding it critical to mention tax neutrality as a central trait of the overall fiscal policy being pursued.

As a compromise the Council finally agreed on a wording of the recital stating that arrangements made in connection with the implementation of this Community framework are a matter for each Member State to decide, In this regard, Member States might decide not to increase the overall tax burden if they consider that the implementation of such a principle of tax neutrality could contribute to the restructuring and the modernisation of their tax systems by encouraging behaviour conducive to greater protection of the environment and increased labour use.

Dual use and state aid

From mandatory to facultative

During the negotiations, the Commission proposal to extend the mandatory exemption for mineral oils used for other purposes than motor fuel or heating oil (or non-fuel uses) to all energy products, including the specification to include dual uses (chemical reduction, and metallurgical and electrolytic processes) under the exemption, had only received limited attention. While a majority of countries seemed to agree with the Commission proposal, it was problematic to some Member States.

First, Denmark had repeatedly tried to raise Council attention to a serious, but also a rather particular, Danish problem. The problem was that an extension of the existing mandatory exemption for non-fuel uses to cover all energy products, would entail the removal of energy taxes on certain industrial processes in Denmark. This would work to the detriment of both the environment and Danish state revenues.

Second, pulling in the exact opposite direction were Belgium, Portugal, Ireland and Greece, who from time to time had insisted on a need to include mineralogical processes in the concept of dual use, and thereby also under the mandatory exemption[33]. The principal reason given for this was that these processes were similarly energy intensive as the processes covered by the dual-use exemption and that they would therefore be subjected to unfair competition if not included. The claim was further that it could not be ruled out that energy products used in mineralogical processes in some cases were used as a raw material. The Spanish Presidency had abided to the demand of the four Member States in its proposed guidelines. But other Member States, who would loose state revenues and positive environmental effects if they had to remove existing taxes on mineralogical processes, firmly rejected this.

Thirdly, France, like Denmark, also had a special problem. Having from time to time supported exempting mineralogical processes, France at some point furthermore raised a somewhat surprising demand for a mandatory exemption for electricity, when it accounts for more than 50 percent of the cost of a product. When pressed for an explanation, France would only cite reasons of particular national concern.

In an attempt to satisfy everyone's wishes, and at the same time solve its own national problem, the Danish Presidency eventually proposed to make the exemptions for non-fuel use and

[33] Mineralogical processes includes i.e. lime, cement, glass and ceramics.

dual use facultative and to treat mineralogical processes and electricity, when it accounts for more than 50 percent of the cost of the product, in the same way.

State aid approval of dual use exemption in Britain

Meanwhile the concept of dual-use received what has probably been its most clear interpretation to date. This was in connection with a Commission approval of the British Climate Change Levy in April 2002[34].

In the approval the Commission first accepted that it was within the logic and nature of an environmental energy tax system aiming to provide incentives to use energy more efficiently, to levy the tax on energy products used for fuel purposes, while exempting energy products used purely for non-fuel purposes (or as raw material)[35].

The Commission subsequently noted that where an energy product is used for both fuel and non-fuel purposes there appeared to be considerable practical difficulties in levying the tax only on the part of the product used for fuel purposes. On this basis the Commission considered that it was within the logic and nature of the tax system to provide an exemption for energy products used primarily as a raw material, but where it also provides, as a by-product, an element of heating. It was finally accepted not to include mineralogical processes in the dual use exemption, on the basis that energy in these processes are used principally for fuel purposes (and thus not as a raw material).

State aid crisis

At a September 2002 meeting of a special high-level group, established under the Spanish Presidency to secure advancement, the high representative from Belgium asked if the Commission, on the basis of the state aid rules of the treaty, would be able to reject exemptions made in accordance with the new directive. Belgium was in this regard particularly concerned about the facultative exemptions for non-fuel use, dual use and mineralogical processes proposed by the Presidency.

In response to the Belgian question, the Commission explained that Treaty rules always have prerogative over directives. The Treaty rules on state aid did however allow the application of certain exemptions from the standard tax rates. Important in this regard was how harmonised a directive rule was. Total harmonisation, e.g. in the form of a mandatory exemption having to be implemented by all Member States, would provide full legal certainty in terms of state aid. Facultative exemptions on the other hand had to be notified and accepted according to the guidelines on state aid.

Finding a life of future uncertainty about the application of state aid rules unbearable, Belgium now set a tough ultimatum, saying that either at least the exemptions for dual use and mineralogical processes were made mandatory, and thereby legally certain in terms of state aid, or Belgium would reject the hole proposal, and with it the very idea of expanding the current EU framework for the taxation of energy to all energy forms. Portugal, Greece and Ireland soon joined in on the Belgian ultimatum. Also Spain, at this point, seemed close to dropping its newly found support for the directive.

Besides the traditional opponents, the outlay of the state aid rules made by the Commission had also made some of the traditionally strong energy tax supporters like Austria and Sweden weary. Their representatives now seemed quietly to consider a mandatory exemption for dual use, including mineralogical processes, as a high, but possibly also necessary, price to pay to safeguard national exemptions for heavy industries against the possibility of future negative Commission state aid decisions.

[34] Commission decision of 3 April 2002 on the dual-use exemption which the United Kingdom is planning to implement under the Climate Change Levy and the extended exemption for certain competing processes (Official Journal L 229/15).

[35] Two reasons were given for this. First, the input of the energy as a raw material is determined by the chemistry of the reactions. A given amount of production requires the input of a given amount of energy product. This chemical and physical relationship cannot be altered. This removes the scope for the producer to improve the efficiency of the operation in terms of the amount of energy product required. Imposing the levy on energy in these circumstances would therefore serve no purpose. Second, the type of raw material required is severely constrained by the chemistry of the reaction. It is therefore not possible for the producer to switch to alternative sources of energy.

On the other side of this new serious divide stood, besides the Presidency, Member States like Germany, United Kingdom and the Netherlands, who were not willing to bear the price in terms of lost state revenues and weaker environmental incentives, that would result from removing existing national taxes on mineralogical processes.

Having reached this serious stumble block so close to the finish line, pressure were now mounting on the Commission to provide some sort of guarantee that exemptions made in accordance with the directive would be acceptable, also in terms of state aid. While the Commission was simply not able to provide any such guarantees on the future application of Treaty rules, it did however, in close corporation with the Presidency, manage to come up with a solution to the state aid crisis.

State aid solution

The solution was first simply to exclude the most contested areas of non-fuel use, dual use, mineralogical processes and electricity, when it accounts for more than 50 percent of the cost of the product, from the scope of the directive. By excluding these areas from the legal provisions of the directive, it would be left completely up to the Member States themselves whether they wanted to tax them or not.

Second, a recital was added to the preamble of the Directive, stating that energy products should essentially be subject to a Community framework when used as heating fuel or motor fuel and that to that extent, it is in the nature and the logic of the tax system to exclude from the scope of the framework dual use and non-fuel uses of energy products, as well as mineralogical processes. Finally the recital stated that electricity used in similar ways should be treated on an equal footing. Finally, the Council and Commission agreed on a statement to the Council minutes, saying:

— that the energy taxation Directive is in compliance with Community commitments to integrate environmental concerns into the energy taxation area, that it will improve the functioning of the Internal Market and that the Commission should go to the greatest possible length to ensure that measures taken by Member States in accordance with the exemptions and tax reductions laid down in the Directive will be considered compatible with state aid rules;

— that Member States may notify for approval comprehensive state-aid schemes laying down the general rules and conditions Member States' authorities will apply when granting aid in relation to the new energy tax directive. After their authorisation, these regimes do not require further notification of the individual cases of application to specific sectors or companies;

— that energy products should essentially be subject to a Community framework when used as heating fuel or motor fuel and that it can be considered that it is in the nature and the logic of the tax system to exclude from the scope of the framework dual uses and non-fuel uses of energy products, as well as mineralogical processes. Member States may then take measures to tax or not to tax or to apply total or partial taxation to each use. Electricity used in similar ways should be treated on a similar footing. Such exceptions to the general system or differentiations within that system, which are justified by the nature or general scheme of the system, do not involve State aid.

Professional use of diesel

The treatment of diesel used for professional purposes proved to be by far the most difficult political problem to solve for the Danish Presidency. While having reached overall agreement on a new minimum tax rate for road diesel fuel of EUR 302 per 1000 litres, the controversy concerned a set of special arrangements for the treatment of professional diesel, which had also been proposed by the Spanish Presidency.

These arrangements would first allow Member States with a national diesel tax rate under the new minimum to apply a special low rate for professional diesel of 287 EUR. This would effectively allow the low-tax countries (including Spain itself), to keep existing rates for professional diesel, while raising their private diesel rates.

Second, Member States with a national rate above the 302 EUR minimum would be allowed to reduce their rates for professional diesel with no more than 5 percent. This would effectively allow France, Italy and the Netherlands to continue with the diesel reduction schemes, that had been introduced after the year 2000 fuel protests after the date of their expiry on the 1 of January 2003, without further Council authorisation.

Finally, the Spanish proposal allowed Member States that were willing to introduce a system of road user charges for lorries and with a national diesel fuel rate of at least twice as much as the new minimum rate, to differentiate in favour of professional diesel, as long as the overall tax burden would be kept broadly equivalent. This last arrangement was addressing a particular concern of the United Kingdom. Carrying the, without comparison, highest diesel tax rate in the Community, the United Kingdom wanted to be able to lower the rate for professional diesel in connection with a planned introduction of a road user charge system for heavy goods vehicles.

Catering to the interests of the low-tax Member States Spain, Austria and Luxembourg, the three Member States with professional diesel reduction schemes, France, Italy and the Netherlands, as well as the special case of the United Kingdom, Germany had good reasons to feel isolated by the Spanish proposal. Germany still carried bitter memories of the year 2000 fuel protests and how France had stepped back on its clear promises to the ECOFIN Council not to lower its national diesel fuels taxes. While firmly rejecting the Spanish diesel fuel proposal, Germany was demanding an answer to a more principled question, concerning the overall value of ECOFIN agreements, when some Member States would just allow themselves to disregard them only days after they were made. Raising the stakes Germany would now also firmly reject the Presidency proposals to let businesses go below the minimum levels in return for agreements and to allow Member States to exempt agricultural and horticultural works and forestry and inland fisheries.

Meanwhile, as an alternative to the Spanish proposal, the Commission had come up with a brand new independent proposal to introduce arrangements for diesel fuel used for commercial purposes and to align the excise duties on petrol and diesel fuel[36]. Suggesting a gradual path towards full harmonisation of national diesel tax rates in 2010, around a centrally fixed, and with inflation gradually increasing, Community tax rate starting on EUR 350, the Commission proposal was however immediately rejected by not only the low-tax countries, but also most of the high-tax countries, which did not want to see a maximum cap on commercial diesel taxation.

In an effort to solve the diesel tax debacle the Danish Presidency proposed a compromise whereby all Member States were first given the possibility to differentiate between commercial and non-commercial use of diesel, provided that the new Community minimum is observed and that the rate for commercial diesel does not fall below the national level in force on the 1. January 2003. Second, the group of Member States with current national rates under the new minimum rate were allowed to keep these rates, but only for a limited periods of time. Third, the French and Italian diesel reductions for commercial road transport were authorised for an additional period until the end of 2004. Fourth, Britain was allowed to lower its rate on diesel in return for the introduction of road charges as proposed by the Spanish Presidency. Finally, in an effort to sweeten the pill for Germany and the Commission, the Danish Presidency proposed that the minimum level for diesel oil for road purposes were to be increased to a level of EUR 330 per 1000 litres from 2010.

The Member States were not able to agree on the Danish compromise proposal on professional diesel in time to meet the December 2002 deadline. Together with the issues of business minimum rates and the treatment of agricultural and horticultural works etc., the issue was pushed forward to the upcoming Greek Presidency.

[36] COM (2002) 410 final.

THE FINAL AGREEMENT

The nerve racking stand-off between especially France and Germany on the question of professional diesel was to drag on all the way into the Italian Presidency in the second half of 2003 when Germany finally gave in. This prepared the way for the final adoption of the ETD after more than ten years of negotiations, just in time for it to enter into force on 1. January 2004.

THE ENERGY PRODUCTS TAXATION DIRECTIVE

Left after almost ten years of tough Council negotiations on how to arrange the common legal framework for the taxation of energy in Europe, is a considerably watered down directive text containing a somewhat complicated set of Community rules, with several areas open for further interpretation in Member State capitals, the Commission and, in the last instance, the European Court of Justice.

The rates

The new energy tax directive provided only a small nominal increase in the minimum taxation of mineral oils (more or less following the rate of inflation since the adoption of the Mineral Oils Directive in 1992) and, more noteworthy, new positive minimum tax rates on electricity, natural gas and coal (see annex A).

The final rate levels lies considerably lower than what was originally proposed. Still, the levels were, unlike what had been the case with the Mineral Oils Directive, in some cases higher than the lowest common denominator, meaning that some Member States actually had to make small upward adjustments or introduce new taxes on certain energy types and uses (especially on electricity).

The new Directive moreover secured that the new Member States from mainly Eastern and Central Europe had to introduce the same minimum levels of taxation as the rest of the Community[37]. This after some transitional periods agreed to in the Treaty of Accession and in an amendment to the Energy Tax Directive, which generally go along the lines of those allowed to existing Member States[38].

While laying out the tracts for the introduction of energy taxation throughout the new extended EU, the low minimum levels of taxation introduced must still, on any account, be regarded as too low to provide any significant environmental incentives.

The structure

Besides expanding the tax base to cover all energy products, the new directive has provided a more flexible structure, making it easier for Member States to introduce energy tax policies

[37] In one case the old Member States even arranged it so that the new Member States have to implement a higher rate than most of the old Member States. According to Article 9 (2) of the Directive Member States, which on 1. January 2003 are authorised to apply a monitoring charge for heating gas oil, may continue to apply a reduced rate of EUR 10 per 1000 litres for that product. As none of the new Member States were authorised to apply the lower monitoring charge on 1. January 2003 they will have to implement the standard minimum rate of EUR 21 per 1000 litres. With heating gas oil being a common fuel used in heavy industrial processes, this provision distorts competition in favour of the old Member States. It is therefore doubtfull that it would be upheld in the European Court of Justice. In any case the provision has to be repealed on 1. January 2007 if the Council, acting unanimously on the basis of a report and a proposal from the Commission, so decides, having noted that the level of the reduced rate is to low to avoid problems of trade distortion between the Member States.

[38] Commission press release IP/04/575.

tailored to national requirements. On top of extended possibilities to apply differentiated tax rates, far-reaching consideration were, towards the final phase of the negotiation process, taken to respect existing Member State practices. This, among other things, involved a considerable limitation of the tax base and an extension of the list of facultative exemption and reduction possibilities.

The base

While the energy tax products directive resulted in an environmentally beneficial expansion of the common tax base to cover all main energy products, it, on the other hand, also entailed an environmentally unfortunate limitation of the tax base in relation to the specific energy uses covered. As an effect of the exclusion of chemical reduction, electrolytic, metallurgical and mineralogical processes, together with electricity when it accounts for more than 50 percent of the cost of the product, from the scope of the directive, large parts of Europe's most energy intensive industrial processes are left uncovered by the EU energy taxation framework.

One of the central objectives of the energy tax directive was to enhance the room of manoeuvrability for Member States wanting to tax energy products for environmental purposes. This by working against harmful tax competition, where lower or no energy tax rates in one Member State give rise to the relocation of business, and thereby loss of tax revenues and employment, in another Member State, with higher tax levels. By leaving large parts of the most heavy energy intensive processes outside the scope of the directive, the ETD must be seen as having failed in achieving this central objective, when it comes to the very industrial sectors most sensitive to relocations.

For practical reasons wood, peat and the output taxation of heat were also left outside the scope of the directive. As wood and peat are considered as biofuels Member States were already allowed to exempt them. The reason why they were left outside the directive anyway was to make sure that they were not covered by the rules for movement and control of excise duty products. Inconsistent is that wood and peat (CN code 4401 and 4402) are both explicitly excluded from the scope of the directive (article 2.4.a) and exempted (article 16.1). The output taxation of heat was left out in order to make sure that such taxation would not later become interpreted as illegal.

Facultative exemption and reduction possibilities

Differentiations

Member States are now entitled, without prior Council authorisation, to differentiate tax rates between different qualities of energy products. This provision will most likely be used mainly to promote environmentally beneficial qualities, but it could also be used for other purposes. Member States are now also able to differentiate tax rates between certain uses, mainly targeted at the provision of various public service provisions. Member States have finally been given the right to differentiate between business and non-business use, as well as, under certain conditions, between commercial and non-commercial use of diesel for road transport[39].

The business/non-business differentiation possibility, together with the possibility to limit the scope of the reduced level of taxation for business use, provides Member States with a high degree of flexibility when designing national energy tax systems. This can be used to differentiate between households and businesses, but also between certain business sectors such as e.g. agriculture and retail. In practice Member States have in this way been given an extra possibility, besides the business reduction possibilities otherwise given by the directive (see below), to apply a reduced rate level for certain business sectors, given however that Treaty state aid rules are respected.

High flexibility makes it easier for Member States to overcome barriers involved with the introduction of national energy tax systems. The drawback lies in lower degrees of harmonisation and a higher possibility for Member States to give in to pressures for lower tax rates on specific activities that it, from an environmental point of view, might have been better to cover by the standard tax rates.

[39] Article 5 in Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

The possibility to differentiate between commercial and non-commercial diesel above the national rates that were in place on 1 January 2003 makes future environmentally beneficial increases in national rates for commercial use of diesel for road transport less likely. On the other hand, the possibility has made it easier for Member States to harvest both environmental and fiscal benefits by increasing the rate for private diesel.

Business reductions

According to the energy tax directive Member States can grant reductions to both energy intensive and non-energy intensive businesses. An energy-intensive business is defined as a business entity where either the purchases of energy products and electricity amount to at least 3.0 percent of the production value or the national energy tax payable amounts to at least 0,5 % of the added value[40]. Member States may apply more restrictive concepts, including sales value, process and sector definitions.

A reduction for energy-intensive businesses can go down to zero, in return for the conclusion of agreements, tradable permit schemes or equivalent arrangements leading to the achievement of environmental objectives or increased energy efficiency, broadly equivalent to what would have been achieved if the minimum rates had been observed[41]. A reduction that goes down to 50 % of the minimum can also be made for non-energy intensive businesses under this condition[42]. Otherwise reductions for non-energy intensive businesses can go down to the minimum tax level were agreements are concluded, or where tradable permit schemes or equivalent arrangements are implemented, as far as they lead to the achievement of environmental protection objectives or to improvements in energy efficiency[43].

The EU business reduction scheme establishes a common balance between what have been regarded as a need to safeguard international competitiveness and the objective to provide businesses with incentives for increased energy efficiency. Following the demands of several Member States in the Council, this balance can only be seen as having tilted heavily towards the protection of international competitiveness.

The threshold for energy intensive businesses is loose and somewhat open for national arrangements. Depending on which of the two possible threshold values that Member States apply, the group of companies covered will vary from Member State to Member State and over time. This will occur along with either fluctuations in international energy prices or changes in national levels of energy taxation.

Further weakening the business energy tax scheme is how Member States are able to go down to zero for energy intensive business and down to 50 % of minimum rates for non-energy-intensive businesses. Pulling, to some extent, in the other direction is however that the business reductions can only be done in return for entering into energy conservation agreement, tradable permit schemes or equivalent measures.

The weak overall business energy tax scheme further adds to the image of a directive failing to fulfil its most central objective of enhancing the room of manoeuvrability for Member States wanting to apply energy taxation through the prevention of harmful tax competition. Having said this, it should on the other hand be recognised as a real environmental achievement, that the idea of combining energy tax reductions with energy conservation agreements or other measures, using the threat of taxation as a stick to make businesses uphold these measures, is now established on the EU level.

[40] Article 17 (1a) in Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

[41] Article 17.1.a and 17.4 in Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

[42] Article 17.3 and 17.4 in Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

[43] Article 17.1.b in Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

Other facultative exemption possibilities

The new energy tax directive adds biofuels, electricity production based on renewable energy sources and hydro power to the list of areas where Member States are allowed to provide total or partial exemptions or reductions in the level of taxation. Together with a continuation of the existing exemption possibilities for energy products used in combined heat and power production and in the field of pilot projects for the development of more environmentally friendly products these exemptions can be seen as facilitating the promotion of environmental and energy efficiency objectives.

While it was possible to extend the list of facultative exemptions with activities that should be encouraged for environmental and energy efficiency reasons, it was not possible, because of Member State resistance in Council, to remove activities which only purpose is to safeguard the competitiveness of certain sectors. This means that the environmentally unfortunate exemption possibilities for fuels used in dredging operations in navigable sea waters and in ports, in the field of the manufacture, development, testing and maintenance of aircraft and ships and finally in agricultural and horticultural works and in forestry and inland fisheries remains.

In order to secure Member State approval it was furthermore necessary to include an exemption possibility for households and charitable organisations, which eventually ended up being a facultative exemption covering all non-business activities, including public organisations. While exemptions for non-business activities does not have any direct effect on intra-Community trade and thus competition, they do seem to run somewhat against the nature and logic of an common energy tax system aiming to promote energy conservation throughout Europe. Particularly exemptions for public organisations would seem somewhat arbitrary, it being public organisations wanting to encourage energy conservation through tax incentives in the first place.

Mandatory exemptions

As one of the significant environmental achievements of the ETD can be seen a limitation of the mandatory exemption for air navigation, making it possible for Member States to tax fuel used for domestic air flight or between Member States that conclude a bilateral agreement. However, the EU framework still falls short of introducing a EU-wide aviation fuel tax on kerosene used by EU carriers for domestic and intra-Community flights corresponding at least to the new Community minimum tax rates for diesel and kerosene (more about this below).

While the taxation of aviation fuels was thoroughly analysed and discussed during the energy tax negotiation process, no significant attention seems to have been given to the issue of sea navigation. A silent agreement seems all along to have existed among the Member States and the Commission to carry on the mandatory exemption for sea navigation in the mineral oils directive to the new energy tax framework. The exemption for fuels used in sea transport can to some extent be justified by environmental aims to promote some kinds of sea transport as a more sustainable mode of transport in comparison to air and land transport. However, there seems to be a limited case for exempting fuels used in the fisheries sector. While entailing some administrative difficulties (the main problem being to prevent large fishing trawlers from shopping fuel in non-EU countries with lower or now taxes) these would probably be exceeded by the environmental benefits of introducing energy taxes on fuels used in the, in many ways, environmentally unsustainable fishing industry[44].

As a minor environmental setback can be seen an extension of the existing mandatory exemption for mineral oils used in the production of mineral oil products to cover all energy products used in the production of energy products, if the consumption consists of energy products produced within the cartilage of the establishment.

[44] See Mikkel Thrane "Environmental Impacts from Danish Fish Products: Hot spots and environmental policies", Aalborg University 2004 (http://ekstern.aau.dk/). In a strategy to make environmental protection a more central part of the Common Fisheries Policy the Commission has made a commitment to adopt the principle of polluter pays in the Fisheries area (COM(2001) 143 final). This calls for at least a thorough study of the economic and environmental advantages and drawbacks of implementing the EU minimum taxes on mineral oils used in the fisheries sector.

The establishment of the principle of output taxation of electricity can also be seen as environmentally unbeneficial. Member States are however, for reasons of environmental policy, allowed to subject fuels for electricity production to taxation, as long as the taxation is not taken into account for the purpose of satisfying the minimum level of taxation on electricity. It is moreover probably possible for Member States to design an electricity output tax, with exemptions for renewable energy sources, which in practice would have the exact same effect as an environmentally related input tax. This on the basis of the high flexibility given to Member States in terms of given effect to such exemptions either directly, by means of a differentiated rate or by refunding all or part of the amount of taxation.

CONCLUSIONS

Based on the historical account of the policy making and negotiations leading up to the final adoption of the ETD and the critical review of the final agreement, some conclusions on the issue of EU energy taxation are now provided.

These will first draw attention to some critical questions concerning state aid, emissions trading, air navigation and road transport that are currently on the EU energy tax policy agenda. Second they will point out an overall need to establish a more coherent and effective framework for the national application of energy taxation in the EU. Finally some perspectives for the future are drawn up.

State aid

One of the most crucial questions for the time to come concern how the rules of the energy tax directive will work together with the Treaty rules on state aid. Can Member States be legally certain that the Commission, and in the final instance the Court, will consider future measures taken in accordance with the rules of the directive as compatible with the Internal Market? And what will the Competition officials of the Commission or the judges of the ECJ eventually regard as being in the nature and the logic of an energy tax system by?

While these questions will be answered on a case-by-case basis in the time to come and are difficult to answer beforehand, it is in any case worth while to recall how the fundamental structure of the Treaties was designed to ensure the application of Treaty rules independently from varying political and economic deliberations of the Member States in the Council. Full legal certainty of specific energy tax rules can therefore only be ensured at an Inter-Governmental Conference, through an amendment of the Treaty state aid rules, an event that seems unlikely, considering the overall value that Member States place on these rules for the proper functioning of the Internal Market.

With this first point clear, there is however also no doubt that the Commission has committed itself politically to the recital and statement for the Council minutes on state aid made in connection with adoption of the Energy tax Directive.

First, this means that the Commission really can be expected to go to the greatest possible length to consider measures taken in accordance with the Directive as compatible with the state aid rules. The question is then what will be the “greatest possible length” in practice? The Commission will obviously still have to clamp down on any clear cases of discrimination and Internal Market distortion, even though skilful national officials might attempt to base such arrangements on the provisions of the new energy tax directive. The Commission will on the other hand have a hard time rejecting national schemes made in accordance with the new energy tax rules, as long it can be reasonably argued that they are of a general and undiscriminating character. In other words, the burden of proof whether or not a concrete scheme is compatible with the Internal Market will most likely fall more on the side of the Commission in future state aid evaluations, as an effect of the political agreement made.

Second, it means that the Commission in the future will probably do what it can to consider it as in the nature and the logic of an energy tax system to exclude from the scope of the framework non-fuel uses, dual uses and mineralogical processes of energy products and electricity, and thus allow Member States to exempt these uses without first having to notify for state aid approval with the Commission. This task will be considerably more difficult for the Commission to fulfil however, especially when it comes to the exclusion of mineralogical processes.

Before the state aid agreement, the Commission considered it not to be in the nature and logic of an energy tax system (that aims to create incentives for energy efficiency) to exempt energy products used for mineralogical processes. This was based on the fact that energy used for mineralogical processes is principally used for heating purposes, and thus not as a raw material. Now, as an effect of the state aid agreement, the Commission has obligated itself to consider it to be in the nature and logic of an energy tax system to exempt mineralogical processes. However, in order to do this, without compromising the Treaty principle of non-discrimination, it seems that the Commission will also have to consider all other industrial processes (mineralogical as well as non-mineralogical) as equally outside the scope of the energy tax system, as long as it can be proven that just a minimal part of the overall process constitutes non-fuel use. This could in practice entail the exclusion of most parts of Europe's manufacturing industries from the scope of the energy tax directive. Before sliding so far however, it is likely that the ECJ will get a chance to clarify what is in the nature and logic of an energy tax system to exclude or not exclude from the tax base.

Another opportunity for clarification will come when the Commission guidelines on state aid for environmental protection are up for possible revision some time before the 31 December 2007. On this occasion Member State calls for recognition, in the Commission guidelines, of the state aid agreement made in the energy tax directive will probably be adhered to by the Commission, in one form or the other. Some Member States might even try to go further, asking for arrangements, like e.g. reductions for energy intensive businesses or renewable energy, to be recognised as in the nature and logic of energy taxation, and thereby not as state aid. It is unlikely however that the Commission will further compromise its competence within the area of state aid in this way, at least not on this occasion, where there are no benefits in terms of increased harmonisation to be gained in return.

Emission trading

While the Council of Economic and Finance Ministers were struggling to unanimously adopt the energy tax directive, the Council of Environment Ministers managed to establish a EU Greenhouse gas (GHG) emission allowance trading system, as a serious contender to the role as the main climate instrument in Europe.

The new EU-wide GHG emission-trading directive went into force 1 of January 2005. The trading system is based on the national allocation of tradable emission allowance permits to a limited set of activities in the energy and industrial sectors (refineries, combustion, iron and steel, paper and pulp, building materials). For a three-year initial phase, Member States are obliged to allocate a quantity of emission allowance permits that is consistent with a path towards achieving Member State reduction targets. From 2008 to 12, the so-called Kyoto phase, the allowances allocated shall be consistent with the Member States obligation to limit its GHG emissions.

Emission allowance trading has been started, with allowance prices growing steadily. A question now contemplated in the Commission and in national capitals is how to integrate the new emissions trading system with systems of energy and CO2-taxation.

The Commission has taken its first step, by stating in an informal note to the Member States that: "The Commission considers that the two instruments of energy taxation and emissions trading, as far as they pursue the same objective, should in principle not apply to the same entity. Thus some adjustment of energy tax rates for those entities participating in the trading may have to be considered. The opportunity of presenting an initiative will be assessed in an upcoming Communication on the used of market based instruments. As far as they pursue the same objectives, the application of both energy taxation and CO2 emissions trading to the same production process will cause an inexpedient double regulatory burden and thereby raise the risk of policy failure. It therefore seems

important, that Member States are given the possibility to exempt enterprises from energy taxes, if they are covered by the emissions trading scheme."

While most Member States are still contemplating how to address the possible problem, Denmark and the United Kingdom have already acted in two different ways. In Denmark the CO2-tax has been partly reduced for fuels used for heating purposes in installations that are covered by the emissions trading system. In the UK the Climate Change Levy on industrial energy consumption has remained untouched, while the emissions trading system has been integrated as an essential element in the energy conservation agreement system affiliated with the climate change levy. Energy intensive companies are given a reduction in the levy in return for entering into and upholding energy conservation agreements. If companies are not able to live up to the agreement they are entitled to buy emissions allowances instead of paying the tax.

It seems reasonable, that Member States shall be given the possibility to exempt enterprises from energy taxes, if they are covered by the emissions trading scheme. It is important to bear in mind however that it is still uncertain, that the emission trading system will in fact provide the promised reductions in CO2-emissions. This will not be the case if emission allowances are allocated too generously by Member States. Adjustments of energy tax rates should therefore only occur as far as it can be established, with a high degree of certainty, that the emissions trading system will in fact provide equivalent incentives as the energy taxes that it is supposed to replace. It should in this regard furthermore be considered whether the two instruments of energy taxation and emissions trading could work positively together as supplements in overall industrial GHG reduction schemes rather than as irreconcilable alternatives. The United Kingdom model seems to provide a good example for such a solution.

In contemplating the relationship between energy taxation and emissions trading it should also be borne in mind that taxes on energy used by the trading sector might also have significant fiscal objectives. In these cases, there might be other reasons to maintain taxation. This very much depends on whether the trading system is based on the free allocation of allowances, as it is generally the case today, or whether Member States are allowed, and if so are willing to, auction of the emission allowances.

When emission allowances are allocated for free, financial transfers do not occur from the enterprises to the state, but rather between the trading companies. Making this system even less similar to a national tax is that a large part of the financial transfers will occur internationally, mainly from countries with strict emission limits to countries with more amble limits. If emission allowances were instead auctioned, transfers would occur from the covered companies to the state. In fiscal terms this would make the trading system more similar to the tax that it might then replace.

Also making the case for auctioning as the main allocation mechanism is the question of administrative costs. While the current system of grand-fathering involves a high degree of government and EU intervention in the hole process of elaborating and controlling national allocation plans, the use of auctioning involves the market mechanism more fully, by leaving it up to the enterprises themselves to decide the demand for allowances at the given level of supply.

Finally, on a more general level, it is also worth noting how the trading system runs against the original Pigouvian idea of having the producer reimburse the general public for the external costs caused by the production. With the distribution of free emission allowances, the value of the external costs caused by production is not given back to the public, but is instead handed over to the producer himself. A probable, but seemingly rarely discussed, effect of this is a considerable incentive for producers to simply close shop and sell the emission allowances obtained. This provides a handsome publicly funded pension for the owners or maybe funds to facilitate a move to countries lying outside the EU emissions trading zone. In this perspective, the EU emissions trading system can basically be regarded as some sort of state subsidy to European industries wanting to move their activities to third countries.

Air navigation

With the adoption of the energy tax directive Member States are now allowed to tax fuel used for domestic sea and air navigation and, by means of bilateral agreements, fuel used for intra-community transport.

Following the new rule, an aviation fuel tax has been introduced in the Netherlands. A suggestion to introduce an EU-wide aviation fuel tax has furthermore attracted attention. The idea, which was presented in a Commission staff working paper from the Development Directorate, is to introduce a tax on kerosene used by EU carriers for domestic and intra-Community flights at EURO 330 per 1000 litres (corresponding to the 2010 Community minimum rate for diesel and kerosene) and to use the 7 billion EURO per year expected from this tax to finance EU development programmes. It has furthermore been suggested to combine the fuel tax with a common per passenger flight departure tax levied on flights leaving Community airports. A differentiation in this tax between intra-community and international flights could work to level out a distortion in competition in favour of third country carriers that would be created by implementing the fuel tax alone. The additional 6 billion EURO expected could also be used for development aid.

While having received some high profile support from both the French President, the German Chancellor and the British Prime Minister a common aviation fuel tax, earmarked for development aid, probably still has a long time coming. First, a common initiative needs to be accepted by all 25 Member States. With at least Spain and Ireland having already voiced clear opposition to the very idea of an EU-wide air fuel tax this seems hard to achieve, especially if one also takes the state of economic crisis that the airline industry has found itself since September 11 into consideration.

Second, it is unlikely that a tax designed to provide the EU with direct revenues, earmarked for development aid, would be accepted by even a simple majority of Member State representatives in the ECOFIN Council. Besides running head into the usually highly controversial issue of EU budget financing, the idea of earmarking revenues for special development purposes runs against basic principles of efficient public finance, according to which tax revenues should always go to the general budget in order to be distributed according to overall political priorities.

While a EU-wide aviation fuel tax seems unlikely, a growth in the taxation of fuel used for domestic flights, along the line taking by the Netherlands, is more likely in the foreseeable future. This probably in combination with bilateral agreements between Member States on certain shorter intra-Community routes were air flight is in direct competition with other more sustainable modes of transportation. How the Treaty principles and rules will be applied to such an incrementally developed web of national and bilateral aviation fuel taxes across the EU remains to be seen.

Road transport

The adoption of the energy tax directive provided only a temporary solution to the controversies between Member States in the area of commercial diesel fuel taxation. With considerable variations in national diesel fuel tax rates persisting, international haulers are still encouraged to fill their tanks in Member States with lower tax rates. Besides the continuing environmental and transport problems that the "gasoline tourism" gives rise to, it also still provides high-tax countries with an incentive to lower their rates of taxation, in order to avoid losing tax revenues and fuel business.

Adding significantly to the downward pressure on European diesel tax rates are also the continuous demands for tax cuts, raised by national road haulage industries on their respective governments. In this regard the road haulers have managed to boost a popular image of national diesel rates as being a decisive parameter in the competition between road haulers in different countries, even though they are not. Fact is that road haulers operating on international markets face the same diesel tax rates in whatever country they operate in and that they all have equal opportunities either to exploit differences in national rates of taxation, to rationalise their operations in other ways or simply to pass over the tax burden to the final transport consumer.

By allowing Member States to differentiate between commercial and non-commercial diesel, the new energy tax directive has made increases of commercial diesel rates in the low-tax countries less likely. But it has, on the other hand, also made it easier for these countries to harvest the both fiscally and environmentally benefits connected to increases in the taxation of private diesel use. At the same time, the new minimum rates, together with the provision preventing Member States from

reducing only commercial diesel tax rates below what was the national rate on 1 January 2003, still secure against an all out commercial diesel tax race towards the bottom.

The Commission proposal to introduce arrangements for diesel fuel used for commercial purposes and to align the excise duties on petrol and diesel fuel presented during the Danish Presidency in 2002 is still on the table. This proposal promises a lasting solution to the problem of commercial diesel taxation, through the establishment of full harmonisation around a centrally fixed Community rate. Based on experiences so far, it is rather unlikely however, that the EU of 25 Member States will be able, in the foreseeable future, to agree on such a common rate.

Meanwhile, many Member States have introduced, or are seriously contemplating to introduce, new road charging systems for both commercial and private vehicles. Such systems have for a long time worked as a way to finance private roads in Southern Member States (like Italy, Portugal and Spain). In Northern Member States (like Austria, Germany and United Kingdom) they are not being introduced as new regulatory instruments, aiming to cover some of the costs of public road building and maintenance, to regulate traffic flows or to internalise some of the environmental costs connected to road travel (e.g. noise or particles). In these countries road charging also work as a new source of public revenue. When collected from commercial vehicles, some Member States might regard these revenues as a compensation for revenues lost as an effect of “gasoline tourism”.

There is a widespread popular view, again largely promoted by the road haulage industry, of road charging as an alternative to the instrument of fuel taxation, which again plays a decisive role in the competition between road haulers in different countries. On this basis a need to provide reductions in the level of diesel taxation, equivalent to the tax burden created by the new road charging system, is identified.

It is in this regard important to bear in mind that road charging is generally not an effective alternative to fuel taxation, just like fuel taxation is generally not an effective alternative to road charging. Road charging and diesel taxation should instead be seen as supplements, or as two distinct instruments, each with their particular regulatory strengths and weaknesses. Where road charging is particularly effective in terms of recovering infrastructure costs, regulate traffic flows and internalising certain local environmental costs (such as noise), fuel taxation is particularly effective in terms of promoting fuel efficiency, CO2-reductions and better fuel qualities. While both instruments, in theory, could be designed to cover each-others primary target areas, this would entail unnecessarily high administrative complications and costs, far surpassing the costs of keeping the two instruments as supplements.

Finally, it should also be stressed that the introduction of road charging, just like fuel taxation, is not a decisive parameter in the competition between road haulers in different countries. Fact is that road haulers operating on international markets face the same road charges, in whatever country they operate and all of them have equal opportunities to either rationalise their operations or pass over the tax burden to the final transport consumer. Unlike fuel taxation, haulers facing road charges are however not able, in the same way, to exploit differences in national rates of taxation.

A more coherent and effective EU energy tax framework

The establishment of a comprehensive legal framework for the taxation of energy products, covering all major energy types with minimum rates and common structural rules, must be counted as one of the major achievements in the regulatory history of the European Union. The energy products tax directive has firmly established energy taxation as a central area of Internal Market harmonisation and as an important instrument in Community efforts to fulfil its energy and environmental policy goals. The EU has in this way become the world’s first international organisation to require from its Member States to apply energy taxation as part of its national fiscal policy.

This being said, it is also necessary to recognize that following the historically long Council negotiation process, and what in this connection seemed as an endless stream of Member State demands for exemptions, reductions and special arrangements, the directive appears rather tattered.

The final result stands out less like the coherent and effective EU regulatory framework for energy taxation that was originally envisioned and more like, in the words of the former Commissioner for Taxation Fritz Bolkenstein, a Gruyiere cheese, so full of holes that it is hard to see the actual content.

Depending on how the area is settled by EU jurisprudence in the time to come, major parts of Europe's most energy intensive industrial processes are left outside the scope of the directive. International air and sea transport (including fishing) are still mandatory exempted and facultative exemption possibilities are given to major business sectors like agriculture and forestry, as well as to households, non-business organisations and the public sector. This basically leaves commercial and private transport, non-energy-intensive manufactures and the service sectors as the only areas being effectively covered by the minimum energy tax rates, which can generally be seen as to low to provide any real energy efficiency or fuel switching incentives.

The establishment of a more coherent and effective EU energy taxation framework for the future, should at a minimum involve the following improvements:

1) The fixation of stepwise increases in all minimum rates to levels sufficient to encourage real increases in energy efficiency.

2) Inclusion of dual use and mineralogical processes within the scope of the directive. The concept of "dual use" should in this regard be further clarified as processes where energy products are used primarily as a raw material, but where an element of heating is also provided as a by-product.

3) Harmonisation and tightening of the definition of energy intensive business. It might be suggested to base a threshold on the EU minimum tax payable in relation to a tightened percentage of either added value or production value. The definition should furthermore be limited to sectors or processes that can be shown as being particularly sensitive to international competition.

4) Abolishment of mandatory exemptions for air and sea navigation, and the imposition of the standard minimum rates on aviation fuel and boat fuels. Council and Commission work within the ICAO framework for the introduction of taxation of aviation fuel and other instruments with similar effects should furthermore be kept up.

5) Limiting facultative exemptions to activities that should be encouraged for environmental and energy efficiency reasons. This means abolishing exemptions for fuels used in dredging operations in navigable sea waters and in ports, in the field of the manufacture, development, testing and maintenance of aircraft and ships and, most important, in agricultural and horticultural works and in forestry and inland fisheries. It also means abolishing the exemption possibility for households and other non-businesses.

Perspectives

Experience shows that the establishment of a coherent and effective EU energy tax framework could have a long time coming. The ten years of uphill negotiations stressed, more than ever, the difficulties involved with EU decision-making within the area of energy taxation. Providing every single Member State with a veto, the rule of unanimity within tax matters makes it hard to imagine the Council being able to take any comprehensive energy tax decisions in the new expanded EU of 25.

With comprehensive energy tax initiatives ruled out for the time being, further developments in a short to mid-term perspective are most likely to occur on a case-by-case basis, along with Commission decisions in matters of state aid and, in the final instance, with rulings from the EU Court of Justice. More delimited Commission proposals aiming to amend specific areas of the energy tax framework cannot be ruled out in a mid- to longer-term perspective either. A first proposal is already expected, aiming to deal with the possible double regulation from energy taxation and emissions trading. An idea for a EU-wide aviation fuel tax is furthermore being discussed. There are also talk of a emi-

nent re-launch of the Commission proposal harmonise the taxation of diesel fuel used for transport purposes[45] All depending on economic, energy and environmental developments and the political will of Member States, other limited initiatives could also be imagined.

Finally, initiatives on a regional basis could also be imagined. These could be arranged between groups of neighbouring Member States aiming to solve concrete problems connected to e.g. border trade of energy products (e.g. renewable electricity) or the integration of energy operations across the national frontiers through the bi- or multi-lateral harmonisation of energy tax rates and structures. However, besides one example, the so called Eurovignette road user charging system for heavy goods vehicles, there has never been cases of such cooperation. A problem is probably that no Member State has the institutional capacity to facilitate such agreements. The Treaty mechanism of “enhanced co-operation” does provide an institutional tool for increased regional co-operation. This has however not been put to use so far. The reason for this might be that the minimum number of eight Member States necessary to pursue such co-operation is too high and that the negotiation takes place in the Council setting were other Member States are allowed to block initiatives.

On a longer-term perspective a combined effect of increases in Member State energy tax rates, the possible entry of new low or no-tax Member States (like Turkey) and a follow up agreement to the Kyoto climate change agreement could create new momentum for an overall revision of the energy tax directive, aiming to raise the minimum rates and mend some of the many holes of the Gruyere energy tax cheese.

[45] COM (2002) 410 final.

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