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**ADDENDUM to the PROPOSAL**

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from: Commission  
dated: 7 July 2005

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Subject: Commission staff working paper. Annex to the Proposal for a Council  
Directive on passenger car related taxes

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Delegations will find attached a Commission staff working paper from the Commission, submitted under a covering letter from Ms Patricia BUGNOT to Mr Javier SOLANA, Secretary-General/High Representative.

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Encl.: SEC(2005) 809



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 5.7.2005  
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**COMMISSION STAFF WORKING DOCUMENT**

**Annex to the :**

**Proposal for a Council Directive  
on passenger car related taxes.**

**Impact Assessment**

**{COM(2005) 261 final}**

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**A. WHAT ISSUE/PROBLEM IS THE PROPOSAL EXPECTED TO TACKLE?**

**1. What is the issue/problem in the area of passenger cars expressed in economic, social and environmental terms including unsustainable trends?**

This part in the Impact Assessment concerns the identification and analysis of the main problems within the European Union in the area of passenger cars, expressed in economic, social and environmental terms.

Two main strands are considered in this analysis: the functioning of the Internal Market and sustainability.

**From the point of view of the functioning of the Internal Market**, the operation of 25 different tax systems for passenger cars within the EU has resulted in tax obstacles such as double taxation, tax-induced cross-border transfer of cars, distortions and inefficiencies, which impede the proper functioning of the Internal Market.

**European citizens** currently face double payment of Registration Tax (RT), considerable administrative procedures and extra costs, time losses and various obstacles to the free movement of their passenger cars within the Community.

For **the industry**, wide differences in passenger tax systems have a negative impact on their ability to achieve the expected benefits of operating within a single market. Current passenger car market fragmentation prevents industry from exploiting economies of scale, or in producing passenger cars with similar specifications for the entire Internal Market, resulting in significant differences in pre-tax and consumer tax-prices.

As far as **sustainability** is concerned, passenger cars are a major source of CO<sub>2</sub> emissions and are, therefore, of particular relevance to the EU's environmental objective, namely to meet its environmental commitments under the Kyoto Protocol.

Fiscal measures constitute one of the three pillars of the Community strategy to reduce CO<sub>2</sub> emissions from passenger cars. Their optimal use, together with the commitments given by the car industry (ACEA, JAMA and KAMA) and consumer information, is a critical instrument in achieving the Community's target of 120 g CO<sub>2</sub> per Km. Moreover, the reduction in CO<sub>2</sub> emissions goes hand in hand with savings in the specific energy consumption of cars. It, therefore, also has positive implications for the efficient use of energy products, so contributing to the sustainability of energy supplies.

It should be mentioned that the two target areas mentioned above are not entirely linked to each other and thus, measures aimed to improve the functioning of the internal market could be taken without addressing the CO<sub>2</sub> issue and vice versa. However, it makes sense to address both in one single proposal, without prejudice that in this assessment the two issues will be addressed separately.

**2. What are the risks inherent in the initial situation?**

If no action is taken the functioning of the **Internal Market** in the area of passenger cars will not improve. **European citizens** will continue to pay diverse RT in sixteen out of the twenty five EU Member States Double payment of RT will continue to take place when a citizen

permanently moves a car registered in a Member State to another also applying a RT. **The industry** will continue to see fragmentation of its car markets, resulting in loss of opportunities in exploiting economies of scale, improved competitiveness and so on.

In relation to **sustainability**, policy neglect in this area will impact on the EU's environmental objectives and is likely to result in the Community's target of 120g CO<sub>2</sub> per Km not being achieved.

### 3. What are the underlying motive forces?

The passenger car market is still a long way from a true single market and, therefore, any movement towards an approximation of the taxation system will give a strong signal from an **Internal Market** point of view. The existing situation does not satisfy anybody as it involves heavy costs for the citizens, the car industry and trade, and also for the national administrations themselves in terms of the high administrative cost in managing their tax systems.

Although European Court of Justice case law has helped in resolving specific problems that the **European citizens** face, it cannot ensure legal certainty nor can it provide answers to a large number of questions relating to free movement of passenger cars. It is evident, therefore, that legislative action is necessary.

As far as **sustainable development** is concerned, transport is responsible for about 28% of total CO<sub>2</sub> emissions. Road transport alone currently represents 84% of all transport related CO<sub>2</sub> emissions of which more than half is accounted for by passenger cars<sup>1</sup>. Despite the commitments made by the car industry, CO<sub>2</sub> emissions from passenger cars will rise even further, particularly due to increased transport demand, if no effective use of fiscal measures is made. The use of these measures, and particularly of their function as a guiding force, is critical in order to influence consumer's behaviour towards more fuel-efficient passenger cars and thus reinforce sustainable development at Community level.

### 4. What would happen under a "no policy change" scenario?

If no action is taken the proper functioning of the **Internal Market** in the area of passenger cars cannot improve. Continuation of legal uncertainty and lack of transparency will keep transitional costs for passenger cars high. Disproportionate RT levels, including cases of double payment of RT, will keep car retail prices high, pre-tax price differentials will continue and, for low income citizens, the replacement of their cars will be more difficult. Due to lack of Community legislation, the Jurisprudence of the Court of Justice will remain the only refuge for resolving citizens' problems, mainly on the basis of the general principles of the EC Treaty.

As to **sustainability**, the Community's target of 120 g CO<sub>2</sub> per Km will run the risk of not being achieved by 2010. Based on model projections on road transport, CO<sub>2</sub> emissions would increase during the period 1995 to 2010 by +17%. If the Community's target of 120 g CO<sub>2</sub> per Km is implemented this increase will be limited to only +3%. The genuine use of fiscal measures to meet these targets is fundamental to the Community strategy. Fiscal measures

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<sup>1</sup> Passenger car means the category M1 as defined in Annex I of Council Directive 70/156/EEC (OJ L 42 of 23.2.1970, p. 1-15), Directive as last amended by Commission Directive 2004/104/EC (OJ L 337, 13.11.2004, p.13).

provide a strong incentive value, for example, by encouraging the rapid renewal of the car fleet. Failure to use them will mean that there is little incentive for change.

## 5. Who is affected?

It is a fundamental freedom of the single market that **European citizens** should be able to move between Member States without encountering any obstacles such as double taxation. Since completion of the single market in 1993, citizens have reasonable expectations that problems associated with movement - either temporary or permanent - between Member States should have disappeared. The citizen does not understand why he is often asked to pay a RT twice, or why he is not allowed to contest excessive residual values for used cars, established arbitrarily by some Member States of destination, in order to collect high and disproportionate amounts of RT. Last but not the least, the citizen wants a RT refund system, to be applied in all cases where a car is transferred permanently to another Member State or exported. The abolition of RT will reduce the administrative procedures in cross-border transfers of cars and, therefore, the citizen will find it easier to buy his new car in the market of his choice. Finally, car owners will be affected insofar as they will pay more tax to keep on the road a less fuel efficient car, and gain if they own or buy a more efficient one.

The **motor industry** favours an approximation or simplification of fiscal provisions in the area of passenger cars in order to enjoy the potential benefits of operating within a single market, and consequently to improve competitiveness and create new jobs. The car industry is interested in producing cars for the entire Internal Market using the same technical specifications, and so benefit from economies of scale. In the area of used cars the benefits for the car trade are expected to be particularly positive. The proposal aims to introduce Community rules for the establishment of a RT refund system and the application of a transparent method for calculating the residual value of used passenger cars. These measures will tackle the problems of disproportionate amounts for RT in cross-border transfers of passenger cars, and have a positive impact for the car trade.

The cross-border passenger car trade is currently influenced by car pre-tax price differentials and market fragmentation. The proposed gradual abolition of RT is expected to abolish about 20% of these car price differentials. These differentials should be further reduced following the application of the new Regulation on "Block exemption".

**Member States** applying RT are concerned at seeing the administrative cost of managing their car taxation systems rise, due to the expected increases of parallel imports of passenger cars particularly after the entry into force of the new Regulation on block exemptions. This could happen as citizens will be allowed to buy their car anywhere in the Community without any restriction (exclusive representative). Member States will also need to better organise their taxation systems and take any appropriate measure in order to ensure the correct payment of, or discourage the avoidance of paying, the higher Annual Circulation Tax (ACT). Although the global tax revenue is expected to remain stable more administrative effort is needed in order to restructure the tax base of car related taxes and insert a CO<sub>2</sub> element into each of them. To keep car tax revenue stable closer monitoring and rapid adaptation to the new situation is needed particularly in order to adapt the levels of diversified taxes following the reaction of the consumer to the fiscal measures in force.

The **European Regions** are also concerned in certain Member States where car taxes have been *regionalised*. Certainly, the proposed Directive does not affect the tax levels to be applied, or the use to be given to the tax revenue collected, but only the structure of the car tax

base. It is therefore expected that certain Regions will have to gradually abolish or to substantially reduce the level of Registration Tax and replace the relevant revenue loss by the increased revenue from ACT. They will need to take action to restructure the tax bases and monitor the application of the new system. These changes can be taken during the transitional period in a manner that better corresponds to their particular conditions.

**B. WHAT IS THE MAIN OBJECTIVE OF THE PROPOSAL THAT IS EXPECTED TO BE REACHED?**

**1) What is the overall policy objective in terms of expected impacts?**

The overall objective of this proposal is to improve the functioning of the Internal Market and contribute to the Community's strategy to reduce CO<sub>2</sub> emissions from passenger cars.

With regard to the Internal Market, the particular objectives of the proposal are the following:

- Reduce the differences of the European pre-tax car prices due to the level of taxes( mainly to RT)
- Cut down the car market fragmentation resulting from the wide differences in tax systems
- Eliminate the problems of double taxation on cross border transfers of cars
- Reduce transaction costs for the consumer when a car is permanently moved from a Member State to another
- Give the citizen more transparency and legal certainty in the rules applicable to determine the value of a second-hand car during the transitional period until registration taxes disappear

With regard to the Community' strategy to reduce CO<sub>2</sub> emissions from passenger cars and promote sustainability, the proposal only focuses on CO<sub>2</sub> emissions from passenger cars. However, Member States can use fiscal incentives for also reducing other polluting emissions which are regulated for type-approval, such as NO<sub>x</sub> and particulate matters. When revising their national passenger car taxation systems Member States could consider whether additional environmental improvements can be achieved by increasing proportionately the tax rate as a function of car age, as newer cars have major environmental (and safety) benefits compared to older cars. Although passenger car related taxes are not so high in some Member States their consumer guiding capacity is strong and can influence consumer's behaviour to replace or to re-equip old cars or to opt for less polluting new cars. This perspective includes important economic, environmental and social dimensions.

**2) Has account been taken of any previously established objectives?**

The proposal is in line with the objectives of both fiscal and environmental policies.

With regards to **fiscal policy**, the proposed Directive will look different than that presented in 1998<sup>2</sup>, as it will focus on fewer, but important, issues, i.e. the abolition of RT and introduction of a RT refund system. Important elements from the Court of Justice Jurisprudence will be included in the proposal so modernising and simplifying the existing vehicle taxation systems. However, Member States will remain free to apply the level of ACT they wish, to establish the levels of RT to apply during the gradual abolition period, and to delegate the management and the revenue to Regions. A co-ordination concerning the structure of the tax base of passenger car taxes will be proposed at Community level.

With regard to **environmental policy**, the proposal will finally put in place at Community level the use of fiscal measures, which consists *the third pillar* of the Community strategy, endorsed by the Council in 1996, to reduce CO<sub>2</sub> emissions from passenger cars and improve fuel economy<sup>3</sup>.

## C. WHAT ARE THE MAIN POLICY OPTIONS AVAILABLE TO REACH THE OBJECTIVES?

### 1. What is the basic approach to reach the objective?

Four main options have been considered during the preparatory phase of this draft Directive. The basic approach (*option 3*) taken in the draft Directive has been established in the light of the outcome of the consultation of the 2002 Communication on taxation of passenger cars, and a public consultation, and includes the following three measures:

#### a) The total abolition of RT, over a ten year transitional period:

- a gradual, but total, abolition of RT, as this tax represents a clear obstacle to the freedom of movement of cars in the Internal Market and negatively affects competitiveness of the European car industry.
- to ensure revenue neutrality a gradual and parallel transfer of *revenue* from RT to ACT and, if necessary, to other fiscal measures in compliance with Council Directive 2003/96/EC, will be proposed. The latter presents a more stable source of revenue for national budgets and shall reduce progressively the administrative and management costs.
- to reduce car market fragmentation and the existing car pre-tax price differentials and approximate consumer car prices among Member States.
- to allow Member States with a high RT to better face transition costs, and apply all necessary structural changes in their tax systems.

#### b) The immediate establishment of a RT Refund system to apply during the transitional period:

- to avoid excessive and often double payment of RT.
- to ensure legal certainty and transparency for the European citizen.

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<sup>2</sup> COM (1998) 30 final

<sup>3</sup> COM (1995) 689 final

- to establish transparent and objective criteria and rules concerning the evaluation of the real residual value of used cars, and thus ensure a more equitable calculation of the residual RT for outgoing and incoming cars.
- to reduce the number of complaints by citizens by incorporating into Community law a number of elements from the abundant Jurisprudence of the European Court of Justice

**c) The restructuring of both RT and ACT tax bases to include a CO<sub>2</sub> element:**

- This step is necessary in order to allow individual Member States to take concrete measures to implement the existing Community strategy to reduce CO<sub>2</sub> emissions from passenger cars and improve fuel economy.
- To encourage the (optimal) use of fiscal measures and their widely recognised efficiency if used to promote sustainability.

**2. Which policy instruments have been considered?**

In relation to **Internal Market** objective, this proposal will only focus on fiscal instruments and particularly on RT, ACT and if necessary, on other fiscal measures taken in compliance with Council Directive 2003/96/EC, as they are by far the most important passenger car related taxes. The proposal should take into account the conclusions of specific studies<sup>4</sup> on this particular issue.

With regard to sustainable development objective, solely increasing the overall level of the existing tax rates, without changing the tax base, does not provide for a significant effect. The level of RT or ACT, in absolute terms, proved also not to be very relevant for the effectiveness of vehicle taxes with regard to CO<sub>2</sub> emissions of new cars.

On the contrary, replacing the existing taxes with purely CO<sub>2</sub> based taxes and applying sufficiently differentiated tax levels proves to provide the largest emission reductions. Adding a differentiated CO<sub>2</sub> element to existing taxes proves also to provide a smaller but still significant CO<sub>2</sub> reduction. Additionally, the level of potential CO<sub>2</sub> reductions does not depend on the type of the taxes, e.g. RT or ACT, but on whether that tax is CO<sub>2</sub> based and on the level of tax differentiation applied. However, it is essential to modify national taxes starting with either of these taxes, which are of a significant size.

Tax differentiation has been proved to be the key parameter for improving the fuel efficiency of passenger cars, under certain conditions. As shown in the table under paragraph D.1.3 hereafter, the highest CO<sub>2</sub> emissions reduction level, going up to 8,5%, has been calculated in DK, if both RT and ACT were converted to purely CO<sub>2</sub> based taxes and would be differentiated in a co-ordinated manner.

**3. Which options have been discarded at an earlier stage?**

Three more policy options are considered and their potential effects are compared with each other before resulting in the basic approach to reach the objective mentioned under paragraph C 1) above:

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<sup>4</sup> Particularly the COWI study – Main Report, December 2001

a. **A "do nothing" approach (option 1).** This would leave all decisions to Member States and the European Court of Justice (CoJ). As shown in paragraph A 2) above, if no action is taken both the functioning of the Internal Market will not improve and the Community's target of 120g CO<sub>2</sub> emissions per Km will run the risk of not being achieved by 2010.

b. Rely on **existing** passenger car taxes, but only insert **a RT refund system** (option 2), in order to avoid double taxation, which is not justifiable within the context of the Internal Market.

The introduction of a RT Refund system would represent the minimum necessary to tackle the double taxation problem, but does not address any of the other problems the citizens, the car industry and trade face which have been mentioned under point A). Moreover, this refund system would have to be accompanied by a number of Community rules in order to establish objective and transparent methods for establishing the residual value of used cars permanently transferred to another Member State. The residual value is a critical parameter as it serves as the tax base for calculating the residual RT to be refunded or to be charged respectively concerning the outgoing and the incoming passenger cars. As already mentioned, the abundant Jurisprudence of the European Court of Justice provides a solid basis for solving certain situations but do not give legal security to citizens. In the light of the above facts this option is considered insufficient to tackle the existing Internal Market fragmentation and to promote sustainability.

c. Comprehensive EU passenger car policy (option 4) A comprehensive EU passenger car taxation policy would represent an effort to reduce, but not to eliminate, tax obstacles to the functioning of the Internal Market and at the same time to promote sustainability. It would aim to:

- Reduce gradually RT to a level, which will not exceed the level of 10% of car pre-tax prices, over a period of five to ten year starting from the entry into force of the proposed Directive.
- Introduce a RT Refund System for used passenger cars and establish transparent and objective rules concerning the method of evaluating the residual value of used cars, similar to those described under option b) above.
- Restructure the tax bases of both ACT and RT in order to contain CO<sub>2</sub> elements which are directly sensitive to the CO<sub>2</sub> emission of the passenger car, similar to that described under option C 1) above.

This option is not fully consistent with the Commission's opinion that RT is the main obstacle disturbing the free movement and transfer of passenger cars within the Internal Market. However, it represents the second best option as it includes all but one element of the preferred option. The missing element is that this option instead of including the total abolition of RT provides for its gradual reduction to a low level, which has been fixed at a maximum of 10% of car pre-tax price. This option tackles a considerable number of problems, such as the excessive and disproportionate payment of RT, can better ensure revenue neutrality and has a similar impact on the Community's environmental objectives as the preferred option.

However, market fragmentation, car pre-tax price differentials, high administrative costs for managing RT and high social costs for the citizens will continue to exist. Member States applying a RT will need to permanently apply a RT refund system, and to keep in place all existing enforcement and control mechanisms.

#### **4. How are subsidiarity and proportionality taken into account?**

In general it is considered that the proposal strikes the right balance in terms of what is considered a Commission or Community responsibility and what is left to Member States. Some European approach is required in the area of taxation of passenger cars for a number of reasons.

**From an Internal Market point of view** the cost of keeping in place a costly, highly diversified, non transparent and de-motivating system is much higher than the transitional cost of replacing it by a more transparent, simpler, better manageable and flexible system. The new system will continue to be managed at the same level (national or regional) as the previous system, and will not affect the global revenue for the national budgets. Sufficient time is left to those Member States concerned to adapt the tax bases and apply the gradual transfer of revenue from RT to ACT and, if necessary, to other fiscal measures in compliance with Council Directive 2003/96/EC. No Community intervention is planned concerning the levels of ACT, and of fuel taxes that each Member State would consider appropriate to apply. Taxation of fuel taxes has been dealt with in 2003 with the adoption of Directive 2003/96/EC, on taxation of energy products.

**Concerning the environmental or the sustainability** part of the proposal it is again in line with the principle of subsidiarity. It does not introduce any obligation for the Member State to apply passenger car taxes based totally on CO<sub>2</sub> emissions but only to insert a CO<sub>2</sub> sensitive element in these tax bases. The level of this CO<sub>2</sub> sensitive element will be left to each Member State to establish and administer, as well as the level of tax differentiation, according to their own national fiscal and environmental objectives. In general, however, Member States have to apply this element in accordance with the general principles of the EC Treaty and apply it in a manner that does not give rise to border-crossing formalities in trade with other Member States.

The proposal is also proportional to the objective. It does not envisage the harmonisation of either passenger car tax bases or tax levels. It only targets the abolition of RT which is the main remaining obstacle disturbing the functioning of the Internal market and the free movement of passenger cars. The introduction of a CO<sub>2</sub> sensitive element serves the need to achieve the global EC objective of reducing GHG emissions and achieve the Community's commitments given under the Kyoto Protocol.

**D. WHAT ARE THE IMPACTS - POSITIVE AND NEGATIVE - EXPECTED FROM THE DIFFERENT OPTIONS IDENTIFIED?**

**1) What are the (Positive/Negative) impacts of the options selected, particularly in terms of economic, social and environmental consequences?**

**1.1. Economic impact**

**1.1.1. Fiscal importance of passenger car taxation in the Member States**

This chapter provides some background information for assessing the revenue impacts of the policy options described above.

Table 1 in the Annex, shows the share of the car registration tax (RT) out of total tax revenues in the Member States from 1995 to 2002. The figures include the taxes and charges which are levied, under different names, on the acquisitions of new vehicles (excluding VAT). Table 2 in the Annex, displays the corresponding revenue shares of the ACT, levied annually on the ownership of cars. Table 3 in the Annex, shows the revenues in relation to total taxation accruing from transport related fuel taxes<sup>5</sup>.

The conclusions to be drawn out of these tables are the following:

1. There is large amount of variation in the fiscal importance of the RT between the Member States. The RT shares exceed 1.5% of total taxation revenue in six Member States: Denmark, Greece, Malta, the Netherlands, Portugal and Finland, out of which three (DK, EL, FI) are also identified as high RT Member States in TIS Study. By contrast in nine Member States (France, Germany, Luxembourg, Sweden, Czech Republic, Slovakia, Estonia, Lithuania and the United Kingdom), the RT is not used and thus has no fiscal role. The remaining Member States use Registration Taxes, but their fiscal importance is rather small.
2. The ACT shares (table 2) form a more uniform pattern across the Member States. A large majority of Member States apply an ACT, but in no case is this tax as important as RT is in the six high RT Member States shown in table 1. Three Member States apply ACT only on cars used for business purposes (France, Czech Republic, and Slovakia) whilst a further four (Estonia, Lithuania, Poland and Slovenia) use no such taxes. For the EU as a whole the fiscal importance of ACT is bigger than that of RT.
3. RT has remained a stable source of tax revenues for all the MS applying RT, as the revenue shares have been relatively constant over the period considered (table 1). The ACT revenues display more variation for a number of MS, and the fiscal importance of this tax seems to have diminished somewhat for the EU as a whole.
4. Fuel taxes play fiscally a much more important role than RT and ACT in all Member States, and for the EU as a whole their share of budget revenues is about four times higher than that of the RT and ACT together.

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<sup>5</sup> Poland only introduced a RT system as from 01.01.2004 therefore the relevant data is currently missing in all three tables (1, 2 and 3)

### 1.1.2. Registration tax refund scheme: impact on national revenues

The Commission proposes the introduction of a RT refund system to apply to all passenger cars (new or used), which have been registered in the territory of a MS and subsequently are exported outside the fiscal territory of the Community or are transferred permanently to another MS.

Table 1 hereafter contains an estimation of the cost for national revenues resulting from the application of the RT refund system on passenger cars registered in a MS and moved permanently to another MS in connection with a transfer of normal residence. The tax revenue loss associated with the RT refund scheme is calculated by assuming that the RT is removed on all the cars, which are permanently moved from one MS to another, as current double taxation consists of levying a RT again on the cars, on which a RT has been already paid in the "exporting" Member State. The calculation is based on the estimated number of "imported" cars<sup>6</sup>, total number of new cars sales<sup>7</sup> and the RT tax revenues<sup>8</sup>. Only seven RT Member States are included, because TIS Study data is not available for other Member States. It is assumed that the full RT was previously paid on "imported" cars, which is a simplification, since in reality most RT Member States apply depreciation rules which diminish the amount of RT. In this sense the calculated figures should be taken to represent an upper limit of the tax loss associated with permanently imported cars under the RT refund scheme

**Table 1: Tax revenue loss associated with the RT refund scheme**

Member State	Number of imported cars	Tax revenues loss, mio €	Share of tax revenue loss out of RT revenues, %	Share of tax revenue loss out of total taxation, %
AT	8775	14,5	3,3	0,01
DK	6088	112	4,5	0,12
FI	2637	20	1,9	0,03
EL	1043	15,5	1,9	0,03
IE	10116	28,5	12,8	0,10
IT	11264	5,9	0,6	0,00
NL	17015	90,9	3,2	0,06

As a whole, the tax revenue losses associated with refunding the RT on permanently imported cars is not high. In absolute terms the highest losses would occur in Denmark and the Netherlands. In relative terms the biggest loss would be for Ireland, mainly due to the high rate of immigration in comparison with the other Member States, followed by Denmark, in which the RT levels are extraordinary high in comparison with the other Member States. Even in these cases the tax loss would be only about 0,1% of total taxation, and hence the revenue

<sup>6</sup> Number of imported cars is calculated on the basis of number of immigrants for the nine MS and car ownership per 1000 inhabitants in the respective country. The data is from the TIS Study, table 45.

<sup>7</sup> REMOVE baseline data.

<sup>8</sup> EUROSTAT national accounts data.

impact of the scheme would be minor. For the same reason also other economic and distributional impacts would be small, as there would be little need to compensate the revenue loss through increases in other taxes.

However, it should be noted that the estimations shown in table 1 do not take into account the cross-border trade of passenger cars, which does not involve change of normal residence of the car owner. These movements ("parallel imports") are expected to grow if a RT refund system is put in place. If citizens will not be discouraged by fiscal measures, such as the double payment of RT, they are expected to feel free to buy a (new or used) passenger car registered in another Member State and drive it into the MS of their normal residence. For the time being it is not possible to quantify the revenue loss resulting from these transfers of cars. If such activities are practiced by more and more citizens, the revenue loss from the RT refund system could become more important than that shown in table 1 above.

### **1.1.3. RT removal: economic impact**

The impacts of RT removal are wider and more complex than those of the two other policy components (RT refund system and introduction of a CO<sub>2</sub> element in the tax base of vehicle related taxes), and also more difficult to quantify. They also depend on the way the tax revenue loss from RT removal is compensated through increases of other taxes to maintain revenue neutrality, and on the assumptions concerning consumer behaviour.

The impacts are here considered as after the ten year transitions period, i.e. when the RT is totally abolished.

#### *Revenue neutrality assumption*

The fiscal importance of RT revenues varies considerably between the Member States (cf. table 1 and 4 in the Annex), with it being relatively important in only 7-8 of them. Revenue neutrality requires that the tax revenue loss from RT removal is compensated by increasing other passenger car related taxes, in practice the ACT and fuel taxes or both, because only these have sufficiently large tax base to raise sufficient revenues. The amount of this tax shift and the economic and environmental effects of it, are naturally much more important in high RT Member States than low or zero RT Member States.

There are *two* possible *scenarios* for applying revenue neutrality. In the *first scenario* the ACT is a tax levied on the whole car stock. Since the tax base of ACT is much larger than that of the RT, which is levied on the purchases of new cars, the increase of ACT levels per car needed to compensate the revenue loss from RT removal is smaller than the RT previously paid on the car purchase. The differences in average ACT levels between the Member States would increase considerably, although they would not be as high as the differences between the average RT levels before the reform. This can be seen from table 2 hereafter<sup>9</sup>, which shows the average level of ACT per car before (2005) and after (2015) the RT removal in Member States concerned.

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<sup>9</sup> The table is based on TREMOVE baseline data.

**Table 2: Impact of RT removal on average ACT level by 2015 (first scenario)**

Average Level (in € 2000)	AT	BE	DE	DK	FR	GR	IE	IT	LU	NL	PT	FI	ES	SE	UK
RT 2005	1.556	307	0	14.440	0	1.887	3.737	181	12	4.438	4.520	11.108	1.341	0	0
RT 2015	0	0	0	0 CO <sub>2</sub> reduction target	0	0	0	0	0	0	0	0	0	0	0
ACT 2005	180	303	130	370	49	119	292	147	79	494	40	239	57	170	230
ACT 2015	321	335	130	1.347	49	198	585	160	81	811	568	587	144	170	230
Var ACT 05-15	78%	11%	0%	264%	0%	66%	100%	9%	3%	64%	1314%	146%	152%	0%	0%

In this case the average ACT level after the reform is such that the lifetime costs of car ownership for new car owners are lower than before the reform, while the lifetime costs for the owners who bought the car before the reform would be increased.

This problem would not be removed by compensating the tax revenue loss by an increase of both ACT levels and fuel taxes, since higher fuel taxes would also be paid to a large extent by existing car owners.

A *second scenario* would restrict the increase in ACT to customers who have bought a car with a reduced RT. This corresponds to a revenue neutrality constraint at a micro level, which would ensure the constancy of lifetime cost of new cars, and would not affect the cars sold before the reform. On the other hand, the new level of ACT for newly bought cars would be much higher in high RT countries than shown in table 2. While this system would be from an economic point of view the most efficient and the fairest one, one should not forget the complexity of its implementation, as the level of ACT would have to be linked to the year of the registration. There would also be a strong impact on second hand market, as the cars of different age classes would be “earmarked” by different ACT levels. Due to the complexity of this scenario it is not possible to provide estimations for the quantitative impact on ACT level as under the first scenario.

#### *Consumer behaviour assumptions*

The consequences of the two scenarios described above depend on the extent to which the consumers are "rational" or far-sighted, when they decide on the purchase of a car. Two cases can be distinguished:

- 1) Consumers are fully rational and base their purchase decision on the life-time cost of car, instead of retail price.
- 2) Consumers, for various reasons, take mainly account of retail prices, when purchasing a car.

In the first case the RT removal and corresponding increase of the ACT levels would have little impact on car ownership and cars sales. The impacts of the reform from the economic and environmental perspective would be small, but also the benefits in the Internal Market would also remain limited, as high RT differentials would simply be replaced by high ACT differentials. This would be the case in the second tax reform scenario, in particular, in which

the lifetime costs of new cars would remain unchanged. In the first scenario the lifetime costs of new vehicles at the expense of old vehicles would be reduced, which would boost the sales of new cars in high RT Member States.

If consumers, on the other hand, are less far-sighted, car ownership and the demand for new cars would increase somewhat in high RT Member States also in the second tax reform scenario. In the first scenario the impact would be even stronger.

### *Empirical evidence*

Estimation results presented in TIS Study<sup>10</sup> show that retail prices have statistically significant impact on car demand per capita, but ACT and fuel tax levels have no impact in the demand equation in which retail prices are included (table 51). This could be interpreted as indirectly supporting the hypothesis that (in the high RT Member States) car purchases are more affected by retail prices than lifetime costs, although the ACT and fuel tax levels are far from perfect measures for lifetime costs.

Estimation results of the TIS Study show also that pre-tax price differentials are much more strongly influenced by RT levels than ACT levels (table 50). This could again be seen to support the "not- fully rational consumer" hypothesis. Car dealers and producers anticipate the influence of different RT levels on car demand and define their pricing strategies accordingly. Again the evidence is not conclusive and does not exclude that in the case the ACT levels would be increased to the levels, which would keep the lifetime costs of new cars unchanged, car dealers and producers would not change their pricing strategies accordingly.

Scenario results included in the TIS Study provide similar evidence. Scenarios assume that RT levels are reduced in all the Member States so that revenue neutrality is strictly respected. In the two scenarios considered here RT levels are reduced either by 20% (scenario 1) or 50% (scenario 2). In both cases the revenue compensation is made either by a) increasing only ACT or by b) increasing 50% ACT and 50% fuel taxes. The RT and ACT changes only apply to new cars, corresponding to the second revenue neutrality scenario discussed above;

The main scenario results are the following<sup>11</sup>:

- Pre-tax prices would increase in the high RT Member States slightly (between 2% and 5% in scenario 2), but not in proportion to the former RT levels (table 55).
- Retail prices would decrease strongly in high RT Member States (between 11% and 26% in scenario 2), but would remain nearly unchanged in the other Member States (table 56).
- Also lifetime costs would decrease in high RT Member States (1-7% in scenario 2), even if revenue neutrality is assumed in the sense that ACT increases on new cars should exactly correspond to RT revenue losses.

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<sup>10</sup> Estimations in TIS Study are based on disaggregated data containing sales prices and number of sold cars for 20 car models and nine countries representing 50% of the market. Two u-years (1999-2000) are covered in the analysis (see TIS Study, pp. 70-74.)

<sup>11</sup> See the tables 55, 56, 58, and 59 of TIS Study

- Corresponding to the estimation results described above the demand for new cars would react strongly to lower retail prices. As a consequence the sales of new cars would boost in high tax Member States (Denmark +15%, Finland +10%, Greece +5%, and NL +7% in scenario 2, cf. figure 38), but would remain constant or slightly decrease in the other Member States. However, although the TIS study covered only nine MS, it may be assumed that the conclusions are valid for MS throughout the EU. This is because the scenarios covered by the study are representative samples of the different situations in MS applying RT. There is therefore no reason to suppose that consumer behaviour will differ significantly in MS with similar RT characteristics once the assumptions underlying the study are respected. For more specific information on the impact the proposed Directive on the new MS see paragraph D.3.hereafter.
- The average car age would decrease in high RT Member States, but the decrease would be less than 1 year in all the reduction scenarios.

Although revenue neutrality is assumed as a starting point, the final impact on national budgets is not neutral, since the car demand reacts to price changes (cf. tables 58 and 59 of TIS Study). In seven high RT Member States (DK, FIN, EL, NL, MT, CY and PL), increased car demand would more than offset the decrease of taxes, and the revenues of both RT and ACT would increase considerably. The changes look, however, more dramatic than they would be in reality, since it is assumed that RT and ACT changes only apply to new cars, and hence the ACT revenue from the whole vehicle stock is not included in the calculation. In the Member States with intermediate RT levels (AT, IRL, HU and SI) the RT revenues would decrease, but ACT revenues would increase. For Italy both revenues would decrease.

### *Conclusion*

The economic and environmental impacts of RT removal depend entirely on the extent to which car ownership and the demand for new cars are affected. If they are affected, RT removal would have economic and environmental consequences, in particular in high RT Member States. In the opposite case these effects would be neutral or very small. The evidence concerning the nine EU Member States described above is not conclusive, but indicates however, that RT removal would increase car ownership and demand to some extent in the current high RT Member States.

From *the perspective of the Internal Market* the reduction of car retail prices in high tax Member States should leave car producers and car dealers scope for reducing pre-tax price differentials, and hence allow the car industry to better benefit from the Internal Market. However, in the revenue neutral context the ACT levels would need to be increased correspondingly, so that the life time costs of new cars would remain unchanged. Since the differences in RT levels are currently high between the Member States, the differences in ACT levels would be equally high (cf. table 2 above). High ACT differentials between the Member States would also be a form of market distortion, although to somewhat lesser extent than RT differentials, since car demand seems to be more influenced by retail prices than lifetime costs of cars. Hence the impact on pre-tax price differentials would remain rather limited.

In the case RT revenues loss is compensated by 50% ACT increase and 50% by increase of other taxes taken in compliance with Directive 2003/96, the ACT differentials of new cars

would remain smaller, since existing car owners would partly pay for RT removal (thus indirectly subsidising new car owners), leaving somewhat more scope for price equalisation. The other matter is to what extent this solution would be politically feasible.

The evidence from TIS Study supports the above argumentation. The gap between the highest and lowest pre-tax price would decrease at most 4% with respect to the existing situation in the case of 50% RT reduction (scenario 2, table 55). Moreover, car producers base their pricing policies on many different factors, such as income levels, consumer habits, distances etc. and these factors would continue to cause price differentiation between Member States, even if all the tax obstacles were removed.

However, RT Removal would definitely remove the double taxation problem related to exported/ imported cars and hence also the necessity to maintain a RT refund scheme. This certainly is an improvement from the Internal Market point of view, and would also save some administrative costs to national governments.

From *the perspective of car industry* the RT removal would simplify the tax systems and facilitate car trade across the borders in the Internal Market. Lower retail prices would boost the sales of new car models in the high RT Member States, which would naturally benefit the car industry. However, the car producers would still need to take into account the high ACT differentials between the Member States, which would limit the possibilities for price approximation (consumer or pre-tax price approximation). Moreover, high RT Member States form a relatively small share of the market in the EU. Most big Member States (DE, ES, FR, IT, UK) are car producers and have either no or very low registration taxes on new sales. In these Member States retail prices and car demand would not be affected by the RT removal.

#### **1.1.4. Tax avoidance in the area of passenger car related taxes**

Registration tax has the advantage of being charged at the same time that a new car is put in circulation for the first time or when a car changes ownership. Tax avoidance from RT can happen when a car circulates illegally in a Member State using number plates from another Member State. Some of these cars move in the Member State concerned by citizens who initially used the temporary importation regime (maximum six months per calendar year), by citizens who keep a secondary residence and are not allowed to register a car in that second Member State, or by citizens who want to benefit from zero RT rates and potentially lower ACT rates in another Member State.

Currently high taxing Member States are obliged to apply high penalties, and put in place specialised services to carry out controls in order to enforce legislation. Although the cost-benefit effects of these controls are not known, it appears that the whole exercise is costly, non transparent and damaging for the image of the Internal Market.

The proposal will provide for a gradual transfer of revenue from RT to ACT and to fuel tax, over a ten year transitional period. It is certain that the first years of application will be the most difficult for the high taxing Member States. Revenue losses from the reduced RT will have to be covered by both higher ACT and higher fuel taxes. Progressively, the importance of RT will be reduced and the need for controls and enforcement mechanisms will decrease.

## 1.2. Environmental Impact

### 1.2.1. Introducing a CO<sub>2</sub> element in RT/ACT tax bases

The use of fiscal instruments to reduce CO<sub>2</sub> emissions from new passenger cars has been the subject of a study published in December 2001<sup>12</sup>. Model based calculations were done on nine MS<sup>13</sup> and assessed the extent to which passenger car related taxes (mainly RT and ACT) can be effective means to reduce CO<sub>2</sub> emissions from new cars. More specifically, the CO<sub>2</sub> emission reduction target considered in the study was 120g/ km, which is the agreed target of the Community Strategy for reducing the CO<sub>2</sub> emissions from new passenger cars.

The conclusions of the study are the following:

- It is essential to apply a tax scheme, which is directly or indirectly CO<sub>2</sub> related in order to provide for significant reductions in the average CO<sub>2</sub> emissions from new cars.
- It is essential to differentiate the taxes in such a way that taxes for very energy effective cars are significantly lower than taxes for cars with poor energy efficiency.
- Replacing the existing taxes with purely and directly CO<sub>2</sub> related taxes that are sufficiently differentiated provide the largest reductions.
- Adding a differentiated CO<sub>2</sub> element to existing taxes provides smaller, but still quite large, CO<sub>2</sub> reductions. If allowance were made for a subsidy to the most energy efficient vehicles, this would however increase the rate of progression and thus lead to even more CO<sub>2</sub> reduction.
- Merely enhancing the differentiation of existing taxes also provides significant CO<sub>2</sub> reductions, although the reductions are smaller than in the above two cases.
- The level of the potential CO<sub>2</sub> reductions does not depend on the type of taxes, e.g. registration or circulation tax, but more on the CO<sub>2</sub> specificity and the level of the tax differentiation.
- Simple increases of the tax that do not involve changes to neither the tax base (i.e. the parameter(s), which determine the tax), nor to the differentiation schemes provide only very small CO<sub>2</sub> reductions.
- It is essential to modify national taxes that are of a significant size and where there is scope for improving the CO<sub>2</sub> relation of that tax in order to harvest the full potentials of CO<sub>2</sub> reductions within the boundary conditions.
- Fuel tax increases provide only very small reductions of the average CO<sub>2</sub> emissions of new cars compared to vehicle taxes. Fuel taxes may however still be a very effective means of controlling the total CO<sub>2</sub> emissions that are attributable to passenger car transport.

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<sup>12</sup> Fiscal Measures to Reduce CO<sub>2</sub>Emissions from New Passenger Cars. Main report. January 2002. (COWI study). Available at:

[http://europa.eu.int/comm/taxation\\_customs/taxation/vehicles\\_taxation/index.htm](http://europa.eu.int/comm/taxation_customs/taxation/vehicles_taxation/index.htm)

<sup>13</sup> BE, DK, SF, DE, IT, NL, PO, SV, UK

All calculations were made under the assumption that the following three conditions (boundary conditions) would be respected:

- Revenue neutrality has to be ensured, in a sense that no changes in overall tax revenues from vehicle related taxes for new cars should occur (i.e. the total of RT, ACT and fuel taxes).
- Unchanged proportion of diesel cars, which means that the proportion of diesel cars in the total sales of new cars should remain constant at today's level. However, alternative calculations illustrated the implications of allowing for a doubling of the diesel proportion with an upper limit of 50%.
- No downsizing, which implied that the CO<sub>2</sub> reductions should be achieved without major implications for the demand structure in terms of moving demand downwards towards smaller, and hence, more energy effective cars. As an indicator of compliance with this condition, the study has developed a size indicator based on a grouping of the cars into eight categories.

The main results concerning the CO<sub>2</sub> emission reduction potential of three different tax scenarios considered in the study are presented in table 3 hereafter. The first scenario consists of merely increasing the existing differentiation of the RT/ACT according to the car size without introducing any new tax base. The second scenario assumes that a purely CO<sub>2</sub> related element is added to the existing systems, and in the third scenario the existing RT and ACT are replaced by a new purely CO<sub>2</sub> differentiated tax. The CO<sub>2</sub> reduction target is a theoretically defined target for each country corresponding to the Community target of 120g/km for new cars by 2008.

**Table 3:CO<sub>2</sub> emission reduction potential using different fiscal measures**

	B	D	DK	I	NL	P	S	SF	UK
<b>Target CO<sub>2</sub> reduction, % points</b>	<b>10.8</b>	<b>10.5</b>	<b>9.9</b>	<b>11.4</b>	<b>10.2</b>	<b>10.8</b>	<b>10.2</b>	<b>10.7</b>	<b>10.3</b>
<b>Enhanced differentiation of existing taxes</b>									
• registration tax	2.5	-	3.3	-	3.6	1.8	-	2.5	-
• circulation tax	2.4	4.4	5.4	2.7	3.6	1.9	2.4	0.1	4.8
<b>Adding a CO<sub>2</sub> element to existing taxes</b>									
• registration tax	3.3	-	4.6	3.0	3.4	2.1	-	2.8	-
• circulation tax	2.9	4.4	5.0	3.3	4.0	2.1	3.2	3.1	4.6
<b>Purely CO<sub>2</sub> differentiated taxes</b>									
• registration tax	3.5	-	8.4	1.8	5.5	3.2	-	4.3	-
• circulation tax	4.2	5.0	5.5	4.1	6.0	2.3	3.9	3.5	4.7
• combination	5.1	4.9	8.5	4.0	7.0	3.3	3.8	4.3	4.5

Source: COWI Study, Table 1.8: *Summary of main results*

The results show that out of the three scenarios purely CO<sub>2</sub> related taxes provide a largest emission reduction potential in all Member States except in the UK, where all the three

scenarios would have about the same impact.<sup>14</sup> Reductions are largest in DK and NL, in which purely CO<sub>2</sub> differentiated taxes could provide 8,5 and 7 percentage (%) points reduction respectively. The reduction potential is between 4 and 5 percentage points for B, D, UK; IT and FI, while it is somewhat below 4 percentage points for PT and S.

Comparing the two tax instruments it can be noted that the Member States, which currently apply a high RT (DK, PT, FI), would achieve a bit more significant CO<sub>2</sub> reduction by replacing it with a purely CO<sub>2</sub> differentiated RT than by applying CO<sub>2</sub> differentiation to the ACT tax base. On the other hand, in the Member States, where only ACT is applied, equally good results can be achieved by using only ACT as the base of differentiation. In the case of the UK, where a CO<sub>2</sub> based ACT is applied since 2001, a considerable CO<sub>2</sub> reduction is achieved simply by further enhancing the ACT differentiation.

With reference to the new MS, four (MT, CY, HU and LV) apply both RT and ACT at levels equivalent to those of high and medium taxing MS covered by the COWI study, and, therefore, equivalent CO<sub>2</sub> reductions (related to the size of current emissions) can be expected if purely CO<sub>2</sub> differentiated car taxes are applied. Two MS (PL and SI) only apply RT which, according to the COWI study, can produce significant CO<sub>2</sub> reductions depending on the specific characteristics of this tax (such as the tax level) and the level of tax differentiation to be applied. Finally, four MS (CZ, SK, EE and LT) do not apply either a RT or an ACT, and, therefore, the propose Directive would not lead to any CO<sub>2</sub> reductions for as long as these countries do not decide to apply an ACT.

The implication of increasing fuel taxes by 25% were also examined in the study. The results showed that this measure alone would lead to the reduction of the average CO<sub>2</sub> emission from new cars in the order of less than 1%, if no other fiscal measures were applied. Hence fuel taxes are clearly less efficient means of controlling CO<sub>2</sub> emissions than other vehicle related taxes, which does not mean of course that fuel taxes would have negligible impact on all the transport-related CO<sub>2</sub> emissions (and not only new passenger cars).

The impacts in table 3 above are calculated by assuming that the above mentioned three boundary conditions are met. Under these conditions the RT/ACT based fiscal measures are not sufficient to reach the Community target of 120g/km on average for new cars. By allowing the proportion of diesel cars to increase would increase the emission reduction potential in all Member States<sup>15</sup>. However, the theoretical CO<sub>2</sub> reduction target would be reached only in Denmark. According to a specific study<sup>16</sup>, only based on DK, D and UK, the target of 120g/km would necessitate changes to the tax system that involves downsizing in the order of 5% to 12%. Alternative formulations of the revenue constraint would not have significant implications for the potential CO<sub>2</sub> reductions.

### **1.2.2. RT removal: environmental impact**

RT removal would remove at the end of the transitional period the possibility to use the RT base for CO<sub>2</sub> differentiation, which according the COWI study is an efficient way of reducing CO<sub>2</sub> emissions in the case RT levels are high. However, the ACT base can be used for the same purpose, which according the COWI study provides equally good results.

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<sup>14</sup> In the UK the ACT is already CO<sub>2</sub> based, which could explain a somewhat different result in comparison with the other countries.

<sup>15</sup> See COWI study, table 5.16

<sup>16</sup> COWI ENV/C1/SER82002/0029r – Final report November 2003

Since RT removal seems to increase car demand and car ownership at least to some extent, as indicated in the previous section, the emissions of CO<sub>2</sub> and air pollutants, as well as congestion and noise problems would also increase in high RT countries. On the other hand, higher demand for new cars would also lead to more rapid renewal of vehicle fleet, which would counteract the negative environmental consequences of increased car ownership concerning CO<sub>2</sub> emissions. New cars are generally more efficient and less polluting than older cars. Since the two effects are counteracting, the net impact on CO<sub>2</sub> emissions is uncertain. The environmental problems related to urban air quality, noise and congestion would be aggravated in high RT countries, if the increase of car ownership is substantial.

However, combining the RT removal with the CO<sub>2</sub> based differentiation of ACT would bring forth more positive environmental impacts, on the condition of course that CO<sub>2</sub> differentiation is designed in an efficient way. As shown in the COWI Study, in all the three tax schemes analysed in the study the CO<sub>2</sub> emissions from new cars would be reduced substantially, by the amount corresponding to between 30,5% and 86% of the predefined target without relaxing the three boundary conditions mentioned above. The CO<sub>2</sub> emission reduction would be even higher, if downsizing and the increase of the proportion diesel cars is allowed. The latter effect may, however, increase urban air quality problems, as diesel cars are bigger emitters of air polluting substances than gasoline cars. On the other hand, the shift of car demand towards smaller cars would have counteracting effect. The quantification of these different impacts and their net effect is not possible without model-based simulations.

However, it seems certain that potentially harmful environmental impact of RT removal could be at least partly counteracted by the introduction of CO<sub>2</sub> differentiation to the ACT base. In this sense the latter measure is indeed an indispensable part of the proposal, and would be one more important policy instrument for combating climate change in the EU.

### **1.3. Social Impact**

#### **1.3.1. RT refund system and double taxation**

The provisions establishing a RT refund system have the most important impact on citizens, who no longer have to pay the RT twice. The draft proposal will cover two particular cases where the RT refund system will apply.

The first is the particular case where a citizen will move his car permanently from one Member State to another in connection with the transfer of his normal residence. Currently the citizen pays the RT applied by the Member State of registration but he is not allowed (with the only exemption of DK) to receive any residual amount of RT when his car is moved permanently to another Member State or exported outside the fiscal territory of the Community.

The second case is the case where the permanent transfer of a passenger car registered in a Member State is not lined to the transfer of the normal residence of the car owner. This case covers all European citizens who may buy a passenger car (new or used) in another Member State and they want to move it for registration into their Member State of normal residence. If the draft proposal is adopted by the Council the European citizens will no longer be discouraged by fiscal measures, such as the double payment of RT, to buy their car there where they can obtain better prices. This possibility is going to improve the functioning of the internal market in the area of passenger cars as it is the case concerning other products.

Additionally the proposal aims to introduce, for the first time, provisions which directly link the amount of RT to refund or to charge to residual value of the passenger car. In establishing this residual value the authorities will have to take into account the depreciation of the value of a car, on the basis of a list of objective criteria they have to apply. More particularly, MS shall be obliged to establish the amount of RT to reimburse and the amount of RT to charge, on the basis of the same criteria and using the same method of evaluation.

The proposal also provides for the right of appeal of the citizen, if he considers that the authorities did not apply correctly these criteria and they over-evaluated the residual value of his car. These provisions will insert into Community legislation the main conclusions of the Jurisprudence of the Court of Justice and in particular those of the Gomez Valente Case. The tax system should, therefore, become more objective, better balanced and transparent and many issues currently brought in front of national or the European Courts could be resolved at an earlier stage and with much lower cost for the citizen.

### **1.3.2. Less transaction costs for the citizens**

Apart from the double taxation problem the citizen will certainly benefit from the simplification of the procedures necessary for moving a car from one Member State to another. The immediate application of RT refund system is expected to reduce legal uncertainty, increase transparency and reduce considerably the administrative and transaction costs relating to these transfers. Estimations carried out in 2001 evaluate the cost of such a transfer of car in the Member State of destination, involving registration fee, temporary road permits, and other costs, at approximately €351. The citizen will need less effort to provide documents, less money for expert fees and administrative charges and will pay RT in the Member State where his car is actually used. The costs of double taxation are much more important in cases a person moved permanently from a high RT country to another.

### **1.3.3. Cheaper, cleaner and safer cars and more employment opportunities**

The citizens will benefit from lower car pre-tax and consumer prices in the high taxing Member States. This will facilitate the renewal of the car fleet in these Member States and their replacement by cheaper, safer and less polluting cars. Passenger car taxes can play an incentive role and accelerate this procedure. Industry will benefit from increased car sales and will have increased possibilities for enjoying economies of scale, and increased competitiveness and employment.

### **1.3.4. Increase the acceptability of car taxation**

Tax acceptability by the society is an important parameter and cannot be disregarded. This proposal has a clear purpose as it intends to tackle a series of problems the citizens face in their everyday life. It includes measures which do not imply extra revenue for the Governments but only to introduce changes to the vehicle tax structure or to avoid double taxation and improve the functioning of the internal market. The proposal will not include any reference to tax levels to apply by individual Member States and will suggest changes which can take place in a revenue neutral context. The Commission does not ignore the strong feelings of the citizens that that passenger cars are too heavily taxed as compared to other means of transport, and that the current fiscal provisions can play the role of an obstacle to citizen's freedom to buy a car in the place where the conditions are more beneficiary for him within the internal market.

**2) Are there especially severe impacts on a particular social group, economic sector (including size-class of enterprises) or region?**

The proposal aims to keep the global tax burden stable, but this does not exclude the possibility that some citizens will pay more and others less to keep the overall packet revenue neutral. In particular, the owners of old, high polluting vehicles will normally be asked to pay higher ACT or to replace their vehicles with new and less polluting vehicles. To avoid excessive ACT payments, the proposal provides for a gradual application over a period of ten years, which is even longer than the average car age through-out the Community. Therefore, normal car users will buy cheaper cars but they will pay later higher ACT and fuel taxes. Particularly, those travelling more than average will pay more, particularly if they do not buy the most fuel efficient car. The proposal leaves it to each Member State to apply the new measures gradually over a transitional period in the most appropriate manner which best fits with their national conditions.

The measures are expected to have positive effects on the car industry and employment as well as for the consumer. However, some fear that cheaper cars will result in an increase in the total number of cars in the EU market and consequently increased pollution. Others contest this possibility as ill-founded and argue that new cars will replace old and more polluting ones and that car ownership is approaching the market maturity level. Although cars are expected to become a little bit cheaper their use is, on the other hand, going to become more expensive.

**3) Are there impacts outside on the ten new Member States and the Candidate Countries (Bulgaria and Romania) and /or other countries ("external impacts")?**

Based on a number of complaints from citizens, and the information available to the Commission, it appears that similar Internal Market or environmental problems exist also in these countries. ACEA's 2005 Tax Guide contains full and updated information for all ten new Member States. After 1<sup>st</sup> May 2004 the reaction of passenger car market in the new Member States was mixed, due essentially to significant sale drops in Poland (-10.6%) and the Czech Republic (-11.1%), but a +16.6% increase in the Baltic States and 5.8% in Slovakia. In total new passenger car sales in the new Member States reached 820.669 units in 2004, which represents a 5% drop compared to 2003. After a powerful start in the period of accession (+14% in the first four months of 2004), consumers showed uncertainty and reluctance in their purchasing behaviour from May to December, when passenger car sales dropped by 13%. Increases in both the RT and in car prices seem to be responsible for this drop.

According to recent information four new Member States (Czech Republic, Slovakia, Estonia and Lithuania) do not apply RT, three of them (Slovenia, Latvia and Hungary) apply low or medium rate RT, and finally RT seems to be high in the remaining three Member States (Poland (3%-65%), Malta (50.5%-75%) and Cyprus (varies from 0.51 to 8.01 CY Pounds per cc). In Cyprus a CO<sub>2</sub> emissions adjustment is applied and the rates mentioned above are reduced by 15% for vehicles that emit less than 150 g of CO<sub>2</sub> per km, or these rates are increased by 10% for vehicles with an engine capacity exceeding 2250cc that emit more than 275g CO<sub>2</sub> per km.;

A summary of this information appears in Table 7 in the Annex and covers all Member States. However, a more detailed examination of the characteristics of the car related taxes applied by

the new Member States and the implications arising from the application of the proposed Directive, allows us to distinguish three categories:

- The first includes four MS (CZ, SK, EE, and LT), which currently do not apply any RT and ACT. It goes without saying that no implication for their tax system is to be expected from the proposed Directive, apart from having to apply a CO<sub>2</sub> based ACT, if they decide to apply such a tax in future.
- The second category concerns two MS (PL and SI) which currently apply RT, but not ACT. These MS will need to apply fully, as from the entry into force of the Directive, the provisions relating to the RT refund system, the gradual abolition of RT and the introduction of the CO<sub>2</sub> based element. If these MS decide to apply ACT in future they will be free to do so provided that contains the CO<sub>2</sub> based element.
- The third category concerns four MS (MT, CY, HU and LV) which apply both RT and ACT. This category looks similar to the situation in other MS applying both these taxes and therefore these MS are fully concerned by all the adaptations to be carried out during the transitional period.

The 2005 ACEA Tax Guide also includes specific information concerning Bulgaria and Romania.

#### **4) What are the impacts over time?**

There are no model run data available for the time being concerning the medium or long term impact of these measures on the functioning of the Internal Market. Concerning sustainability, some data does exist and will become more detailed in due course when the new version of the TREMOVE model becomes fully operational. Table 3 above, shows that a considerable part of the remaining CO<sub>2</sub> target of 120 g CO<sub>2</sub> per km, can be reached by using fiscal measures in the most optimal manner. However, this means that this target *cannot* be fully reached using only passenger car taxes. A combination of measures is, therefore, needed including fiscal measures which will play a leading role.

### **E. HOW TO MONITOR AND EVALUATE THE RESULTS AND IMPACTS OF THE PROPOSAL AFTER IMPLEMENTATION**

#### **1. How will the policy be implemented?**

Existing car taxation systems implemented in the Member States reflect a variety of influences beyond the obvious need to raise revenue. Geographic, industrial, social, environmental, energy and transport policy considerations have contributed to the type of approach followed. These differences apply both in terms of the overall level of dependence on the sector for a contribution to total revenues, the choice of instruments and their precise implementation.

The fresh proposal will not seek to harmonise these passenger car taxation systems, but instead will aim to better co-ordinate and, at a later stage, approximate them, and so remove tax obstacles and distortions to free circulation of passenger cars within the Internal Market. Additionally, the proposals intend to modernise and simplify the existing vehicle taxation systems by including new parameters in the tax bases of passenger car related taxes, in order to make them partially, or totally, CO<sub>2</sub> based.

Two categories of measures are included in the proposal: those needing immediate action, such as the RT refund system and the restructuring of the car tax bases, and those which can be applied gradually over a ten year transitional period.

Regarding the first category, the provisions introducing a RT refund system that target real problems which distort the functioning of the Internal Market, such as double payment of RT, legal certainty and transparency, obstacles to free movement of passenger cars, need immediate action that has to take place upon entry into force of the proposed Directive. As these measures concern the functioning of the Internal Market as a whole they need to be taken at Community level.

Equally, regarding the CO<sub>2</sub> based car taxes this action also becomes urgent if the goal of achieving a CO<sub>2</sub> level of 120 g/km for new cars by 2010 at the latest is to be realised. Therefore, this action also needs to enter into force at the same time as the proposed Directive. However, individual Member States will be allowed to choose the level of this CO<sub>2</sub> element that is to apply or to opt for a totally CO<sub>2</sub> based taxation system at a later stage.

Concerning the second category of measures and particularly the *transfer of revenue* from RT to ACT, and to fuel taxes, a free hand should be given to individual Member States to apply this transfer gradually by the end of the transitional period. This transfer is feasible and needs to take place in parallel with the reduction of RT, in a revenue neutral context. As each Member States currently applies a different RT level and its budget is dependent on RT revenue at a different level, this action can only be carried out at national level. Additionally, RT and ACT have been regionalised in some Member States and therefore their administration can only take place at national level.

## **2. How will the policy be monitored?**

Member States applying a RT should inform the Commission of the levels of RT they apply to new and used passenger cars on 1 January each year and following each change in national law. Additional information referring to the application of the RT refund system should also be notified, particularly concerning the criteria they apply for establishing the residual value of used passenger cars.

Member States could also include information about the ACT levels they apply, in order to establish a clear global picture of the level of these taxes at Community level. The Commission will insert all this information on a particular place in its website for use by all parties concerned.

Particular information concerning the structure of the tax base of both RT and ACT should also be supplied. This information should specify the level of the CO<sub>2</sub> element in the tax base, and potentially other polluting emissions elements which have been included in the tax base, as well as the level of tax differentiation and the modalities of its application.

The proposal will include provisions for a permanent consultation within the context of the Excise Committee where practical solutions to existing problems can be found and Member States can benefit from each others experience and application of best practice.

### **3. What are the arrangements for any post evaluation of the policy?**

The Commission is able to monitor a number of parameters using the updated version of the TREMOVE model, focusing in particular on the environmental impact of fiscal measures and their contribution in achieving the 120 g CO<sub>2</sub>/ km target. This exercise could be placed within the context of the actions already in place implementing the Community strategy to reduce CO<sub>2</sub> emissions from cars and include them in a particular Annex to the annual report on the effectiveness of this strategy.

The proposal will also provide for the presentation of *two* Reports by the Commission concerning both the application and the results achieved concerning key objectives of the Directive. The first has to be presented five years after the entry into force of the Directive and the second soon after the end of the ten year transitional period. These reports are expected to provide evidence about the progress made in all areas of concern (abolition of RT, functioning of the RT refund system, and the progress made in establishing CO<sub>2</sub> based car taxes). It is possible that the Council will be asked to adopt new measures, after having consulted the European Parliament, in order to achieve the Community's strategic objectives and promote sustainability.

#### **F. CARRYING OUT STAKEHOLDER CONSULTATION**

##### **1. Which interested parties were consulted, when in the process, and for what purpose?**

The Commission has consulted the main stakeholders in the area of passenger cars during three particular periods:

###### **1.1. During the preparation of the TIS and COWI studies.**

- This consultation took place during the years 2000 and 2001, when a close co-operation between the Commission Departments concerned, the consultants, and the main stakeholders was established in order to carry-out these studies. This consultation involved participation in working group meetings, bilateral contacts and regular exchange of information. Particularly, during the preparation of the COWI study, examining the fiscal measures to reduce CO<sub>2</sub> emissions from new passenger cars, this co-operation mainly involved the ACEA, the AIT/FIA<sup>17</sup>, and the T&E<sup>18</sup>. These studies provided background information and model run data and estimations which allowed the Commission to prepare the Communication on taxation of passenger cars in the EU, presented in September 2002. As expected, not all stakeholders shared the same views and often they were in direct conflict with each other.
- The Commission Departments have received considerable information directly from the citizens on this issue, mainly as a result of complaints. This dialogue is to all intents and purposes an open and direct consultation with citizens and is a valuable source of information for the Commission. The Commission provides information to the citizens via the internet<sup>19</sup>, mainly concerning their rights and duties, when they transfer their passenger

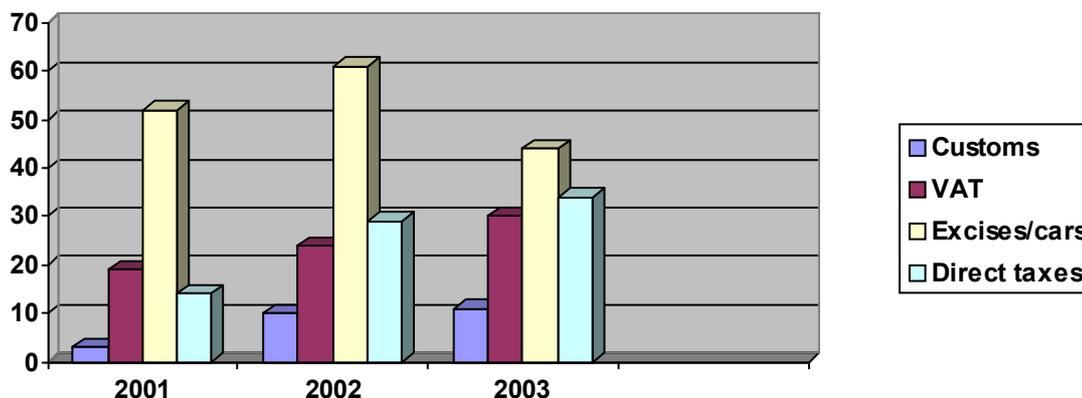
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<sup>17</sup> Alliance Internationale de Tourisme et Fédération Internationale de l'Automobile (AIT&FIA)

<sup>18</sup> European Federation for Transport and Environment (T&E)

<sup>19</sup> TAXUD/255/02 - [http://europa.eu.int/comm/taxation\\_customs/taxation/vehicles\\_taxation/index.htm](http://europa.eu.int/comm/taxation_customs/taxation/vehicles_taxation/index.htm)

car within the Community or use it regularly on cross-border journeys. An overview of these complaints is shown in the following graph:



S

source: DG TAXUD-Unit of Legal Affairs and Enforcement of Community Provisions

## 1.2. During the consultation procedure, which followed the presentation of the Communication on taxation of passenger cars in the EU<sup>20</sup>, in September 2002.

This Communication was long expected and was publicised widely in, and received favourable comments on behalf of, the Press. The Communication aimed at opening a dialogue with other Community Institutions as well as with the important stakeholders on a limited number of policy measures and actions to be considered in the area of passenger car taxation, in order to remove tax obstacles in the internal market for passenger cars, to improve its functioning using fiscal measures as a "tool" to reduce CO<sub>2</sub> emissions from new passenger cars and so contribute to achieving the Kyoto Protocol commitments.

### 1.2.1. Consultation within the European Parliament

This consultation lasted for about one year and took place within the RETT, the REVI and the EMAC Committees, the latter being the Chef de file. A hearing on Passenger car taxation was organised by Ms Honeyball, on 18 March 2003, where ACEA, AIT/FIA and OECD representatives presented the position of their Organisation with regards to the policy recommendations made by the Commission.

Finally, the Rapporteur (Mrs Honeyball) tabled her report on 10.7.2003, and the EP voted its Resolution on 6.11.2003<sup>21</sup>. The European Parliament gave strong support to the Commission's recommendations and

- Called on the Council to implement the third pillar of the Community CO<sub>2</sub> strategy speedily and the Commission to present proposals to abolish registration taxes, and to overcome internal market barriers resulting from these taxes.

<sup>20</sup> COM(2002)431 final

<sup>21</sup> A5-0265/2003

- Found it unacceptable that 10 years after the launch of the Single Market, such a large number of obstacles to transfer of cars caused by administrative practices or procedures still remain;
- Expressed its conviction that, without environment-oriented taxation, the objectives of the three-pillar Community strategy on CO<sub>2</sub> reduction and the shared goal of achieving a CO<sub>2</sub> level of 120 g/km for new cars by 2010 at the latest are in jeopardy and cannot be realised;
- Suggested that a progressively graduated CO<sub>2</sub> supplement to be levied on passenger cars producing more than 120 g/km of CO<sub>2</sub> emissions, which would be added to the basic tax to calculate the final tax level and that rebates to be allowed for vehicles with less than 120 g/km of CO<sub>2</sub> emissions, to encourage the use of less polluting cars, and
- Pointed out that the suggestion to remove the favourable tax treatment for diesel cars in most Member States may be counterproductive insofar as the objective to reduce greenhouse gas emissions is concerned;

### **1.2.2. Consultation with the main stakeholders**

The Commission addressed letters to six main stakeholders, in November 2003, asking for any written comments they might wish to make. Three of them (ACEA, AIT/FIA and T&E) responded with detailed comments. A summary of these comments is shown under paragraph 1.4.

### **1.3. During the preparation of the Commission Proposal and the IA**

The consultation continues at all levels particularly between the ACEA and AIT/FIA, and the Commission. It includes meetings at high political and administrative levels, (the ACEA's President met with Mr Bolkestein, ex Internal Market Commissioner, Enterprise Commissioner Mr Verheugen, and Commissioner Kovacs, responsible for Taxation and Customs Union), and many contacts at expert level such as participation of Officials from either side to bilateral or working group meetings, participation of Commission officials as speakers to periodic meetings organised by ACEA and AIT/FIA. A close co-operation involving information and data exchange has been established and these Associations are consulted on a regular basis.

### **1.4. During a public consultation via the Website**

On 14th July 2004 a public consultation was launched via the Commission's website and was announced by way of a Press Release. It took the form of a questionnaire, which respondents could complete on-line. Although aimed at the public, the consultation was open to anyone who wished to participate. However, respondents were requested to say whether they were a private individual, a business, an association or an official body. The main questions asked in the questionnaire were:

- Do you normally transfer your car to other Member States and, if so, have you experienced any problems?
- Do you think that the operation of 25 different tax systems for passenger cars within the EU has resulted in tax obstacles and distorts the proper functioning of the Internal Market?

- Do you believe that there is a need for some general rules at Community level, as outlined above, concerning passenger car taxation?
- Do you think that environmental concerns related to passenger cars should be addressed at Community level?
- Of the four Options proposed, which would you most favour?

The consultation closed on 10 September 2004.

#### **1.4.1. Overall results**

In total, there were 2,040 responses of which 1,908 (93.5%) were from private individuals, 78 (3.8%) from business, 46 (2.2%) from associations and 8 (0.4%) from official bodies.

The majority of respondents were from Portugal (72%) followed by Finland (8%) and Hungary (5.6%). In our assessment, the small number of responses from some Member States should not be construed as implying that the public in those countries had little or no interest in this consultation. Although the Commission endeavoured to publicise it through its Press Release (and by alerting individual consumer associations), it is fairly clear that the message did not filter down to individuals in all the Member States. Nonetheless, it has been possible from the responses that were received to establish a trend that is almost certainly representative of most Member States.

Although only 377 (18.5%) of respondents normally transferred their car to other Member States, 316 stated that they had experienced problems, citing the biggest problem as being difficulties in claiming a refund of the registration tax, or disproportionate rate of the registration tax, paid in their Member State of normal residence (271 respondents).

Nearly 95% of respondents considered that the operation of 25 different tax systems has resulted in tax obstacles and has distorted the proper functioning of the internal market.

Over 96% of respondents believe that there is a need for general rules at Community level for passenger car taxation and over 93% believe that these should include and address environmental concerns.

The option most favoured by respondents for resolving these problems was *option 3- the gradual phasing out of registration tax, with a refund system to apply in the meantime, and the introduction of a new tax structure linked to CO<sub>2</sub> emissions* –, which was supported by 974 (47.7%) respondents. This was followed by Option 4 - similar to option (3) but rather than a phasing out of registration tax, merely reducing it to a level that does not exceed 10% of the pre-tax price of the car – which was supported by 718 (35.1%) respondents.

#### **1.4.2. Associations**

46 associations, representing consumers and industry, responded to the consultation. Of these, 35 believed that the operation of 25 different tax systems has created tax obstacles and distortions to the proper functioning of the Internal Market, 39 see a need for general rules, and environmental concerns to be addressed, at Community level. *Option 3*, was supported by 29 respondents. In addition, a number of associations made separate representations (outside of the on-line consultation mechanism). In particular:

**The ACEA**, which took a favourable position on:

- the gradual restructuring of motor vehicle and fuel taxes in the EC taken as a packet (holistic approach), in order to:
  - abolish Internal Market fragmentation and install a single EU car market,
  - reduce car pre-tax price differentials that distort fair competition
  - increase sales of new and more environmentally friendly cars.
- taxing *car use* rather than car purchase and ownership, and
- Progressively abolish all RT and establish a refund system and general rules for calculating the tax levied on transfers of cars, for as long as the RT continues to exist. ACEA favoured the shift of the burden from fixed taxes to variable taxes or user charges, to be consistent with the "user pays" principle as well as the principle that vehicles should be taxed to the extent that they are used.
- ensuring revenue neutrality and, if this is proved necessary, use ACT as a means of balancing revenue losses from abolition of RT. In this context ACEA could also accept, under certain acceptability criteria, the use of user charges for taxing car usage as an alternative to soften the increase of ACT and fuel taxes due to the need to collect revenue after the abolition of RT.

ACEA could take a favourable position concerning the CO<sub>2</sub> based component under the condition that the new proposal would not include provisions resulting in losing the competitive advantage European manufacturers currently have in the area of diesel-engined passenger cars, and that:

- it should be integrated into the overall EU strategy to reduce CO<sub>2</sub> emissions;
- it should not be introduced without the prior or simultaneous elimination of all registration taxes;
- it takes fully into account the impact on the competitiveness of the car industry, if taxation on diesel is harmonised to the level applied on petrol;
- the role the more fuel efficient diesel cars can play in achieving the Community's environmental objectives is not ignored, and that a direct and linear correlation between taxes and CO<sub>2</sub> emissions is not established;
- It should not lead to an overall increase of the already high tax burden on passenger cars, which according to their calculations represented 15% of total national tax revenue, or 334 billion Euros in 2001, and
- It should not discriminate against specific classes or segments of cars and it should be simple, cost effective, transparent, predictable and easy to understand by the consumer.

**The Japan Automobile Manufacturers Association (JAMA)** agreed with the Commission's finding that gradual elimination of registration taxes would be beneficial and that

harmonisation of vehicle taxes would help the industry in a number of ways. As regards the restructuring of vehicle taxation, JAMA considered that the introduction of such measures should not create any new distortions or cause confusion within the vehicle market or for consumers. In addition, the overall level of tax should not be increased as a result of the restructuring.

**VDA** (*Verband der Automobilindustrie*) considers that in assessing any revised tax system, fuel taxes, road charges and existing systems for collecting vehicle tax must also be included. It considers the taxation of motor vehicles should be based solely on a combination of fuel taxes and annual circulation taxes and, therefore, strongly supports the abolition of registration taxes in the medium term. It welcomes the proposal for a refund system.

Although the VDA has concerns regarding the use of tax-related measures to meet environmental objectives, it considers that if registration taxes are to be abolished and CO<sub>2</sub> emissions are to be included as a component in the new tax structure, the following conditions should be taken into consideration:

- Registration tax must be abolished as a priority
- Additional burdens on car users should be avoided
- The introduction of CO<sub>2</sub> emissions in the tax base should be the subject of negotiations with the industry
- The future tax system must not discriminate against any particular technologies, vehicles, or of diesels
- There should be a direct and linear correlation between taxes and CO<sub>2</sub> emissions
- The new tax system should be revenue neutral and transparent.

**The AIT/FIA** representing forty million motorists, expressed a broad support for the policy recommendations put forward by the Commission, insisting that *the car and the car user* should be placed at the heart of the policy agenda.

The main observations made by the AIT/FIA were that:

- Motoring taxation is already too high and any further increase will punish car dependent motorists, particularly those on lower incomes. Any car tax reform should be built upon the recognition of the central role that the car plays as the main form of mobility within the EU;
- They share the view that fiscal policy should also pursue other policy goals, such as environmental protection and road safety, but changes should be revenue neutral and provide incentives to motorists to buy cleaner cars.
- A radical rethink of the tax bases of car taxes is necessary, and that they support the introduction of a CO<sub>2</sub> element into these bases.

- They strongly support the phasing out of RT and the introduction of a RT refund system, in order to avoid double taxation, high costs, cheaper and safer cars, and to abolish the barrier to the free movement of the European citizens.

The AIT/FIA regretted because:

- Other obstacles to free movement of cars, such as those linked to motoring insurance, car safety or temporary use of cars in a secondary residence, are not covered by the Commission's packet of measures, and
- the Commission encouraged Member States to align the excise duty on diesel used as fuel by passenger cars to petrol, ignoring that these cars are more fuel efficient and produce less CO<sub>2</sub> emissions

The T&E (see paragraph 1.2.3.) welcomes the reform of purchase and circulation taxes towards CO<sub>2</sub> emissions. It believes that the third – fiscal - pillar of the Community strategy for the reduction of CO<sub>2</sub> emission from passenger cars should be implemented as quickly as possible and urges the Commission to also take on board in the future proposal a change of the base of the company car tax towards CO<sub>2</sub>. They state that the UK offers a very interesting example in this respect, which implies that the particular British sensitivity on EU tax issues can be avoided here.

T&E recognises the need to avoid double taxation and therefore understands the idea of a refund scheme for registration taxes. However, T&E is not convinced of the need to abolish vehicle purchase taxes from an environmental, practical and subsidiarity point of view. On environment, research clearly shows that abolition would lead to higher car possession, and subsequently higher car use and a higher environmental burden. Replacing purchase taxes by annual circulation taxes leads, according to them, to a de facto double taxation of large groups of car owners as people who bought a new car in the past have both paid the purchase tax and are going to pay the higher circulation tax. This makes this reform either technically very complex or politically very unfeasible. On subsidiarity, T&E feels that it should in principle be left to Member States to decide what activities and products they want to tax heavily and what lightly, and hence to leave room for Member States to optimise their transport and environment taxation schemes.

A summary of the results of the public consultation is attached at Table 8.

## **2. What were the results of the consultation?**

The option most favoured by respondents was Option 3 - *the gradual phasing out of registration tax, with a refund system to apply in the meantime, and the introduction of a new tax structure linked to CO<sub>2</sub> emissions*. Among all those who participated, it was supported by 944 (47.5%) respondents. Among the trade associations, it was supported by 29 (63%) of the 46 who responded. In the light of this debate, the Commission base its proposal only on those policy recommendations which have received the support of the European Parliament and of the main stakeholders.

It appears from the consultation that the vast majority of participants agree that it is time to apply the third pillar measures (fiscal measures) foreseen by the Community's strategy to reduce CO<sub>2</sub> emissions from passenger cars, and that fiscal measures should be used as an incentive in order to influence consumer's behaviour towards more environmentally friendly

passenger cars. Most of the participants agreed that car taxes should be restructured in order to at least include a CO<sub>2</sub> element in their tax base to allow tax differentiation in favour of less polluting passenger cars, and could support, under certain conditions, a reform of the existing car tax systems to relate to car use rather than car ownership.

With the only exemption of the **T&E**, all participants strongly supported the gradual abolition of RT and the transfer of revenue from RT to ACT and to fuel taxes. This support was accompanied by the equally strong concern that Member States should abstain from any attempt to increase the overall tax revenue benefiting from this reform and thus increase the overall tax burden to passenger cars. Revenue neutrality should, therefore, strictly be observed.

Most of the participants argued that excise duties on diesel should not be aligned to those for petrol for environmental, and particularly for economic reasons.

Finally, most participants strongly supported the establishment of a RT refund system in order to avoid double payment or disproportionate payment of RT and the improvement of the functioning of the Internal Market.

## **G. COMMISSION DRAFT PROPOSAL AND JUSTIFICATION**

### **1) What is the final policy choice and why?**

The Commission Proposal for a Directive should include a balanced packet of provisions which represent the minimum necessary, in order to improve the functioning of the Internal Market and to promote sustainability in the area of passenger cars. This proposal should aim at providing full transparency to taxation systems applied by Member States without significant or useless intervention at Community level. In this respect it should respect the subsidiarity and proportionality issues at stake. It is important not to go too far in making such issues a Community competence given that these issues are often politically important at national and regional levels.

The proposal should provide, for the first time, for the use of fiscal measures in the area of passenger cars as these measures constitute the third pillar of measures foreseen in the context of the Community's strategy to reduce CO<sub>2</sub> emissions from passenger cars.

*Four* policy options have been assessed at the final stage. A first outcome of an assessment, based on the expected economic, social and environmental impacts, has shown that option 3 was the best option.

### **2) Why was a more/less final policy choice and why?**

The proposal, based on the outcome of the consultation exercise should contain what is absolutely necessary to be managed at Community level. It goes without saying that the proposal will not include a considerable number of policy recommendations which although they appeared in the 2002 Communication, they did not receive sufficient support during the consultation procedure. For instance, recommendations such as taxation of company cars, alignment of the excise duty on diesel used as motor fuel to petrol, or the approximation of provisions relating to the ACT level, although they refer to very important aspects of car taxation, will not be included in the Proposal.

In order to focus only on high policy objectives, the Commission does not consider it necessary to include in this proposal issues relating to temporary use or permanent transfers of cars accompanied by a change of normal residence (Directives 83/183/EEC and 83/182/EEC) or other issues appearing in its 1998 proposal.

### 3) Which are the trade-offs associated to the chosen option?

- **Option 1 and option 2**, would neither enable the Internal Market and sustainability objectives to be met, nor solve the problems that the European citizen and the car industry/trade currently face.
- **Option 4**, although it looks not so different from option 3, nevertheless it includes an important element which differentiates it considerably from that option. This element is the possibility for Member States to maintain a RT at a level which will not exceed 10% of the car pre-tax price. This option, although it can ensure similar environmental effects to those of option 3, it does not address Internal Market issues. In particular, a RT refund system has to remain in place for as long as RT tax is applied, car market fragmentation, tax avoidance, continuation of controls, administrative and social costs for bureaucratic procedures will remain. The citizen will continue to suffer, even if at a lower level, from the problems he is currently obliged to face.
- **Option 3**, providing for the total abolition of RT should lead to both an improvement of the functioning of the Internal Market and to an important contribution in achieving the objectives of sustainability provided for by the Kyoto protocol. The proposal would give impetus to the passenger car industry to fully benefit from economies of scale, and increase competitiveness and to a certain degree employment. An additional obstacle to free circulation of goods and persons will be lifted. Additionally, national taxation systems will be approximated and to a certain degree harmonised particularly as far as the car tax bases are concerned.

### 4) Why should a decision be taken now?

There is a pressing need for these measures. The Community needs to ensure that the safeguards are there to ensure that the Internal Market delivers the expected benefits in such an important sector as passenger cars. The Community should also incorporate into its law the main conclusions of a series of Court of Justice Decisions and so provide legal certainty and transparency to its citizens and economic operators.

The Community has to respect its environmental objectives, honour its international commitments and be consistent with its strategic objectives, which need additional measures in order to be achieved. Recent studies provide sufficient evidence that the proposed measures can be effected in a global revenue neutral environment without raising the overall tax burden for the citizen and the economy.

## ANNEX 1

**Table 1: Vehicle taxation as % of Total Taxation: Car Registration Tax**

	1995	1996	1997	1998	1999	2000	2001	2002
BE	0,2	0,2	0,2	0,2	0,2	0,2	0,2	0,2
CZ	n.a.							
DK	3,0	2,9	3,0	3,2	2,7	2,2	1,9	2,2
DE	n.a.							
EE	-	-	-	-	-	0,1	0,1	0,1
EL	0,0	0,0	1,8	1,9	1,8	1,5	1,5	1,4
ES	0,5	0,5	0,5	0,6	0,7	0,6	0,6	0,5
FR	n.a.							
IE	0,8	0,8	0,8	0,7	0,8	0,7	0,7	0,7
IT	0,0	0,0	0,0	0,2	0,2	0,2	0,2	0,2
CY	0,5	0,5	0,5	0,6	0,5	0,4	0,4	0,5
LV	0,0	0,0	0,0	0,2	0,3	0,4	0,4	0,4
LT	n.a.							
LU	n.a.							
HU	0,2	0,2	0,2	0,2	0,2	0,1	0,1	0,1
MT	6,0	5,9	5,2	5,4	5,5	5,1	4,1	3,7
NL	1,5	1,5	1,5	1,7	1,8	1,7	1,7	1,6
AT	0,5	0,5	0,5	0,5	0,5	0,5	0,4	0,5
PL	-	-	-	-	-	-	-	-
PT	2,5	2,7	2,6	2,9	3,2	2,9	2,8	2,5
SI	0,4	0,5	0,5	0,7	0,7	0,7	0,7	0,6
SK	n.a.							
FI	1,7	2,0	2,1	2,3	2,5	2,3	2,2	2,3
SE	n.a.							
UK	n.a.							
<b>EU-15 (arithmetic average)</b>	1,1	1,1	1,3	1,4	1,4	1,3	1,2	1,2
<b>EU-25 (arithmetic average)</b>	1,2	1,2	1,3	1,4	1,4	1,2	1,1	1,1

Source: Commission Services

**Table 2: Vehicle taxation as % of Total Taxation: Annual Circulation Tax**

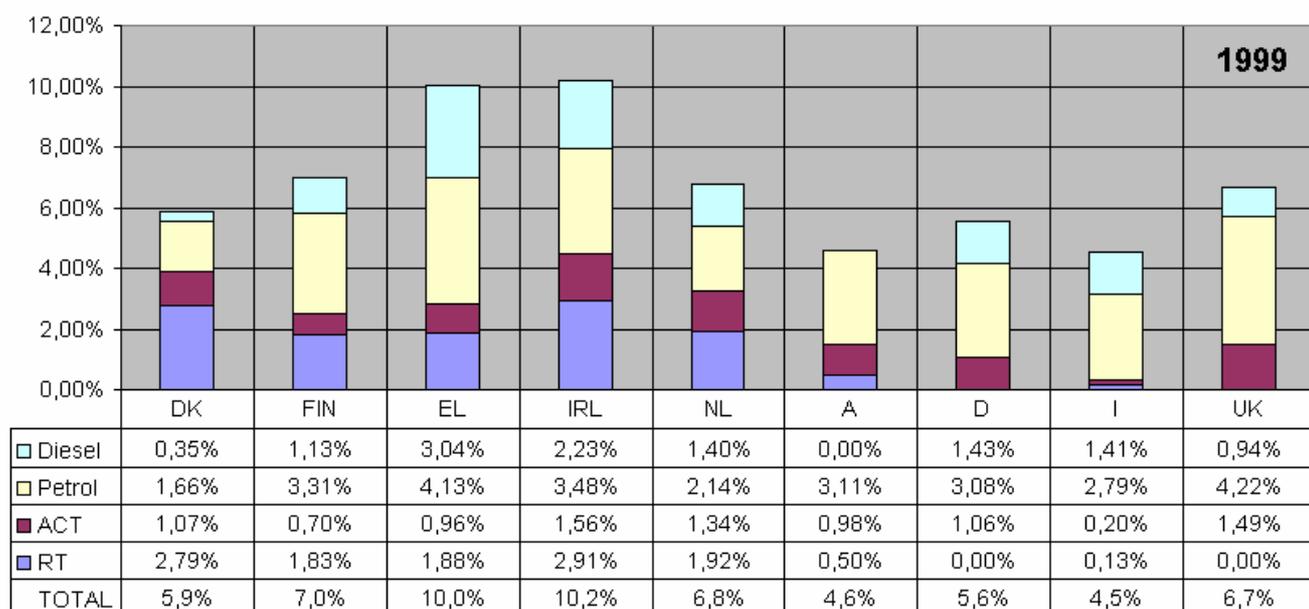
	1995	1996	1997	1998	1999	2000	2001	2002
BE	1,0	1,0	1,1	1,0	1,1	1,0	1,0	1,0
CZ	n.a.							
DK	0,9	0,9	0,9	0,9	1,0	1,1	1,1	1,2
DE	1,0	0,9	0,9	1,0	0,8	0,8	1,0	0,9
EE	n.a.							
EL	1,1	0,8	0,9	0,7	0,9	0,7	1,6	1,3
ES	0,7	0,7	0,6	0,7	0,7	0,7	0,7	0,6
FR	0,5	0,5	0,4	0,4	0,4	0,2	0,1	0,1
IE	1,0	1,0	1,0	0,9	0,9	0,8	0,9	0,8
IT	0,9	0,8	0,8	0,9	0,9	0,9	0,9	0,8
CY	n.a.							
LV	0,0	0,0	0,0	0,0	0,0	0,6	0,6	0,7
LT	n.a.							
LU	0,4	0,4	0,3	0,3	0,3	0,3	0,3	0,3
HU	0,3	0,2	0,2	0,2	0,2	0,2	0,2	0,1
MT	3,0	3,3	3,9	5,4	5,5	5,7	5,6	5,2
NL	1,8	2,2	1,7	1,8	1,8	1,8	1,7	1,7
AT	0,9	0,9	0,9	1,0	0,9	1,2	1,3	1,3
PL	-	-	-	-	-	-	-	-
PT	0,3	0,3	0,3	0,3	0,3	0,3	0,5	0,1
SI	n.a.							
SK	n.a.							
FI	0,7	0,7	0,7	0,7	0,7	0,6	0,7	0,7
SE	0,5	0,6	0,6	0,6	0,6	0,6	0,6	0,6
UK	1,6	1,6	1,5	1,5	1,5	1,3	1,1	1,2
EU-15 (arithmetic average)	0,9	0,9	0,9	0,8	0,9	0,8	0,9	0,8
EU-25 (arithmetic average)	0,9	0,9	0,9	1,0	1,0	1,0	1,1	1,0

Source: Commission Services

**Table 3: Vehicle taxation as % of Total Taxation: Fuel Tax**

	1995	1996	1997	1998	1999	2000	2001	2002
BE	3,2	3,3	3,3	3,2	3,1	3,0	2,9	2,8
CZ	4,7	4,8	4,7	4,7	5,5	4,9	5,4	4,4
DK	2,7	2,8	2,7	2,7	2,8	2,9	2,8	2,8
DE	4,5	4,4	4,3	4,2	4,4	4,5	4,8	4,9
EE	1,6	2,6	3,6	4,5	4,1	3,8	5,2	4,8
EL	8,5	8,4	7,4	6,4	5,5	4,6	4,7	4,2
ES	5,4	5,4	5,2	5,2	5,0	4,7	4,5	4,7
FR	4,2	4,1	4,1	4,1	4,0	3,7	3,4	3,5
IE	5,2	5,2	5,2	5,2	5,0	4,6	3,9	4,4
IT	7,1	6,5	6,2	6,1	6,2	5,5	5,4	5,2
CY	2,0	2,0	1,9	1,9	2,0	2,3	3,1	3,2
LV	3,1	5,0	5,6	7,9	6,4	6,2	5,7	6,2
LT	0,0	0,0	0,0	0,0	0,0	0,0	1,2	0,8
LU	7,5	7,3	7,1	6,9	6,8	6,7	6,7	6,6
HU	6,2	5,7	5,9	7,2	7,0	6,1	5,7	5,6
MT	3,2	3,2	4,6	6,1	5,7	4,9	5,0	4,3
NL	3,5	3,4	3,5	3,5	3,3	3,2	3,0	3,3
AT	3,1	3,3	3,0	3,0	3,0	3,0	2,9	3,1
PL	-	-	-	-	-	-	-	-
PT	8,1	7,8	7,1	7,2	6,6	5,2	5,4	6,0
SI	-	-	-	-	3,3	5,8	6,7	6,6
SK	-	-	-	-	-	-	-	-
FI	4,6	4,5	4,9	4,7	4,7	4,1	4,3	4,4
SE	4,0	4,1	3,9	3,8	3,5	3,3	3,5	3,7
UK	6,6	6,8	6,6	6,7	6,7	6,5	6,0	5,9
EU-15 (arithmetic average)	5,2	5,2	5,0	4,9	4,7	4,4	4,3	4,4
EU-25 (arithmetic average)	4,5	4,6	4,6	4,8	4,6	4,3	4,4	4,4

**Table 4: Revenue from vehicle related taxes as % of total taxation, in 1999**



Source: TIS study, Figure 26

**Table 5: Number of passenger cars in the EU (of 14) in 1,000 units**

<b>MEMBER STATES</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
<b>Austria</b>	3.594	3.691	3.783	3.887	4.010	4.097	4.182	3.987
<b>Belgium</b>	4.239	4.308	4.373	4.458	4.547	4.629	4.684	4.723
<b>Denmark</b>	1.685	1.744	1.788	1.822	1.847	1.843	1.875	1.890
<b>Finland</b>	1.888	1.930	1.935	2.008	2.069	2.121	2.146	2.180
<b>France</b>	25.100	25.500	26.090	26.810	27.480	28.060	28.700	29.160
<b>Germany</b>	40.404	40.988	41.372	41.674	42.324	43.772	44.383	44.650
<b>United Kingdom</b>	24.307	24.865	25.594	26.269	26.775	27.185	27.790	28.480
<b>Greece</b>	2.240	2.241	2.401	2.568	2.811	3.156	3.415	3.650
<b>Ireland</b>	990	1.057	1.134	1.197	1.269	1.319	1.385	1.440
<b>Italy</b>	30.301	29.911	30.155	31.056	32.038	32.584	33.239	33.700
<b>Netherlands</b>	5.633	5.740	5.931	6.120	6.343	6.539	6.710	6.850
<b>Portugal</b>	2.560	2.750	2.950	3.150	3.469	3.593	3.746	3.880
<b>Spain</b>	14.212	14.754	15.297	16.050	16.847	17.449	18.151	18.730
<b>Sweden</b>	3.631	3.655	3.701	3.791	3.890	3.999	4.019	4.040
<b>EU-14</b>	<b>160.784</b>	<b>163.133</b>	<b>166.505</b>	<b>170.859</b>	<b>175.720</b>	<b>180.346</b>	<b>184.426</b>	<b>187.400</b>

Source: ACEA Website (ANFAC)

**Table 6: Car Ownership per 1000 inhabitants for Member States applying different levels of taxation**

**(Years 1991 – 1999)**

	HIGH TAXING			MEDIUM TAXING			LOW TAXING		
YEARS	DK	FIN	EL	IRL	NL	AU	DE	IT	UK
1991	310	387	173	239	351	403	442	502	396
1992	312	387	184	244	353	418	452	519	399
1993	313	372	193	251	358	428	483	522	404
1994	312	371	204	263	365	437	491	521	410
1995	324	372	215	276	367	448	497	530	417
1996	334	379	214	294	372	459	503	535	425
1997	341	378	229	313	383	470	506	543	436
1998	345	391	245	328	393	482	508	546	446
1999	353	408	253	360	408	495	516	555	456
2002 <sup>22</sup>	350	419	344	371	425	492	541	581	473
2002	<i>Community average (CE-15): 493</i>								

**Source:** TIS study, Table 2 and the ACEA Auto data (Historical series) 2001-2002

<sup>22</sup> Estimation made by the Commission Departments (DG TAXUD), based on ACEA's 2002 figures

**Table 7**

**Summary of Passenger car related taxes in Member States<sup>23</sup>**

<b>Member State</b>	<b>Registration taxes</b>	<b>Approximate amount of registration taxes and charges (EUR)</b>	<b>Annual circulation taxes and charges</b>	<b>Approximate amounts, annually (EUR)</b>
<b>Belgium</b>	Registration tax ( on the first registration) Tax base is cc	Range from 61,5 to 4,957	Road tax (based on engine rating) varies according to fluctuations in the retail price index. A supplementary tax on cars, estate cars and minibuses diesel	Range from 57 to 1,458.
<b>Germany</b>	None		Road tax base on cc, weight and EU emission standards ( private cars)	
<b>Denmark</b>	Registration tax. Tax base is price incl. VAT. Advantages for save and eco-friendly cars	Rate is differentiated with price, 105% up to DKK 62,700 and 180% of remainder	Green owner's tax, weight tax and equalisation tax	
<b>Spain</b>	Registration tax. Tax base is price excl. VAT	Rate is differentiated with cc and diesel or gasoline. Range from 7 to 12 %.Rates can be increased up to 10% by Regional Government	Road tax based on engine rating	Established by local government
<b>Greece</b>	Registration tax. Tax base is the higher between ex-factory value	Rates take into account engine capacity and anti-pollutant	Circulation tax levies on a half-yearly basis	Between 38 and 483 € depending of the engine

<sup>23</sup> Information, based on ACEA Tax Guide 2005

	of the vehicle+ freight+insurance or paid price	technology		capacity and FH
<b>France</b>	None		Different taxes settled annually :  -Graduated tax on motor vehicles (vignette), on company cars and certain commercial vehicles  -Tax on company cars	Rates depending of the engine capacity, the age and the district in which it is registered
<b>Italy</b>	Registration tax. Fixed amount that can be increased by each Province up to 20%	150.81  (180.97)	Ownership tax calculated on the basis of Kw	Rates can be differentiated depending on the Regions
<b>Ireland</b>	Registration tax. Tax base is price incl. VAT	Rates depending on the cc between 22,5 and 30%	Ownership tax calculated on the basis of cc	From 151 to 1343 € per year
<b>Luxembourg</b>			Ownership tax calculated on the basis of cc	From 18.59 to 337.14 € per year
<b>Netherlands</b>	Registration tax. Tax base is price excl. VAT	Rate is differentiated between petrol(45,2%) /diesel(45,2%)	Road tax based on the dead-weight, type of fuel used and the region	Rates can be differentiated depending on the Regions
<b>Austria</b>	Registration tax. Tax base is price excl. VAT. Bonus-malus system for particle emissions	Rate is differentiated with fuel consumption. Maximum 16%	Vehicle tax based on the horse powers	Rates in function of the Kw.
<b>Portugal</b>	Registration tax. Tax base is cm3		Municipal car tax based on the cc and the age of the vehicle	

<b>Finland</b>	Registration tax. Tax base is price excl. VAT.	28%	Basic tax Power tax	Cars registered before 1/1/94-26 cents/day After 1/1/94-35cents/day 24.45/a for every 100kg
<b>Sweden</b>	None		Annual road tax based on the weight and the fuel used	
<b>United Kingdom</b>	None		Road tax based on engine size (existing cars) and on CO <sub>2</sub> emissions and fuel type ( new cars)	
<b>Czech Republic</b>	None		Road tax but only for passenger cars used for commercial purposes. Various reductions for meeting EURO emission limits etc Technical and emission inspections.	From 1200 to 50400 CZK 13-26 (determined by petrol or diesel driven)
<b>Hungary</b>	Consumption tax (RT) - based on engine size and catalytic converter or not. Wealth tax, based on size of engine	10% -20% of purchase price of car. Differentiated petrol and diesel cars 15HUF/cm <sup>3</sup> <1890cm <sup>3</sup> 20 HUF/cm <sup>3</sup> >1890cm <sup>3</sup>	Environmental examination depending on fuel type and engine size Motor vehicle tax based on weight, paid annually	14-33 8000HUF
<b>Latvia</b>	Motor vehicle tax based on vehicle's age at time of acquisition	373 for new vehicle 223 for 2 year old vehicle	Road traffic tax based on weight	18 – 107
<b>Malta</b>	Registration tax (1 <sup>st</sup> registration)	Vary from 50,5% of car value if <1300cc, up to 75% if >2000 cc	Road tax paid annually	Rate depends of the engine capacity
<b>Slovakia</b>	None		Road tax (only payable on passenger cars used for commercial	From 1700 to 5900 Sk

			purposes based on engine size)	
<b>Slovenia</b>	Registration tax (1 <sup>st</sup> registration)	1% -13% purchase price	None	
<b>Cyprus</b>	Registration tax on new vehicles based on cc, type of vehicles and with a CO <sub>2</sub> emissions adjustment	Rates ranging from 0.51 CYP per cc for cars <1450 cc up to 8.01 CYP for cars >2650 cc.  -15% for cars emitting <150 g CO <sub>2</sub> Km, but +10% for cars >2250 emitting >275g CO <sub>2</sub> Km	Road tax based on cc and with a CO <sub>2</sub> emissions adjustment	Tax rate depends on the engine capacity
<b>Estonia</b>	None		None	
<b>Lithuania</b>	None		None	
<b>Poland</b>	Registration tax based on the value/price and the years of the vehicle	Tax rate between 3.1 and 65%	None	

**Table 8**

**Summary of the results of the public consultation**

**There were 2040 responses to the consultation –1908 from private individuals, 78 from business, 46 from associations and 8 from official bodies.**

**A. NO AND % OF RESPONDENTS PER MEMBER STATE**

PT	FI	H U	IE	DE	ES	BE	U K	M T	AT	D K	FR	NL	PL	Othe r	E L	LU	IT	SE	CZ	SI	SK	C Y	LV	L T	EE
1481	159	115	48	34	34	33	22	20	18	15	12	10	10	5	4	4	3	3	1	1	1	0	0	0	0
72.5	7.8	5.6	2.3	1.7	1.7	1.6	1.1	1	0.9	0.7	0.6	0.5	0.5	0.2	0.2	0.2	0.1	0.1							

**B. MAIN QUESTIONS AND NUMBER OF RESPONSES**

Number transferring cars to other Member States	Number experiencing problems transferring cars to other Member States	Nature of problems	Number believing 25 different tax systems creates obstacles and distorts Internal Market	Nature of obstacles	Number believing need for Community rules	Number believing environmental issues should be addressed at Community level

		Claiming refunds	Lack of information	Other		Double taxation	Pre-tax and consumer price differences	Market fragmentation	High production costs	Other		
377	316	271	101	59	1929	1493	1291	589	340	163	1973	1906
18.5%	15.5	13.3	4.9	2.9	94.4	73.1	63.2	28.8	16.6	8	96.6	93.3

### C. THE OPTIONS AND NUMBER SUPPORTING EACH

Options				
1 – Do nothing	2 – retain existing taxation systems but introduce a refund system to avoid double taxation when cars transfer to another Member State	3 - the gradual phasing out of registration tax, with a refund system to apply in the meantime, and the introduction of a new tax structure linked to CO2 emissions	4 - Similar to option (3) but rather than a phasing out of registration tax, merely reducing it to a level that does not exceed 10% of the pre-tax price of the car.	None of the afore-mentioned
8	266	974	718	67
0.4%	13	47.7	35.1	3.3