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FISCAL INCENTIVES FOR MOTOR VEHICLES IN ADVANCE OF EURO 5

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1. Introduction – Why this document now?

Several Member States have announced their intention to provide fiscal incentives for motor vehicles that fulfil stricter emission limits, than those set out in Directive 98/69/EC¹ relating to measures to be taken against air pollution by emissions from motor vehicles (i.e. Euro 4). A short overview of the situation in the Member States is provided in section 2.

This paper is aimed at providing Member States with indications on which limit values to base these fiscal incentives on.

Why is there a need for providing such indications?

- First, when Euro 4 will become mandatory as of 1 January 2005 no Community framework for granting fiscal incentives based on pollutant emissions from light duty vehicles will any more be in place. From a legal point of view, Member States will then be free to introduce fiscal incentives for light duty vehicles that meet emission limits which go beyond the ones laid out in Euro 4. However, Member States will have to respect certain obligations when introducing such fiscal incentives. These are detailed in section 3.
- Secondly, the Commission is not in a position to submit a formal proposal on Euro 5 to the European Parliament and the Council before the first half of 2005. The results of the various impact assessments that have been undertaken so far in the framework of the Clean Air for Europe Programme still need to be introduced in an overall thematic strategy on air pollution (see below section 4). Such a formal Euro 5 proposal would have provided a basis on which those Member States that want to introduce fiscal incentives already in early 2005 could rely. More information on work currently underway to develop Euro 5 is detailed in section 4.
- Thirdly and most importantly, these indications are aimed at avoiding a fragmentation of the Internal Market. In other words, the Commission recommends Member States to base their fiscal incentives on the indications provided in this working paper. The proposed indications are set out in more detail in section 5.

Finally, how Member States should best use these indications is further explored in section 6.

The Commission services would like to underline from the outset that these indications are only aimed at addressing the question of fiscal incentives for motor vehicles that fulfil stricter emission limits than those set out in Directive 98/69/EC. These indications do, therefore, not prejudge the future Euro 5 limit values that the Commission will propose formally in 2005. Furthermore, the Commission services would like to stress that these indications are limited to particulate matter (PM) emissions from diesel passenger cars and small (class I) light duty diesel vehicles. According to the information that is at this stage available to the Commission services, all those Member States that want to introduce fiscal incentives, wish to apply them to these vehicle classes based on certain PM emission limit values (see section 2. below). The present indications do not address emissions from gasoline vehicles, which is without prejudice to the formal Commission proposal on Euro 5.

¹ OJ L 350, 28.12.1998, p. 1.

With regard to oxides of nitrogen (NO_x) there are still some doubts remaining about whether advanced after treatment systems will be available in time for inclusion in the formal Euro 5 proposal. Thus, the Commission services consider it likely that in the short term limit values will be proposed for NO_x emissions from diesel passenger cars and small (class I) light duty diesel vehicles that would not require de NO_x catalysts (or other NO_x after treatment systems) for achieving them. The present paper, therefore, does not address the emission of NO_x.

2. Situation in the Member States

A number of Member States have indicated that they intend introducing fiscal incentives in 2005 for motor vehicles that fulfil stricter emission limits than the ones that will become mandatory under Directive 98/69/EC (Euro 4) as of 1 January 2005.

The German government indicated that it was aiming at introducing fiscal incentives as of 1 January 2005 based on the values that would be proposed under Euro 5. In order to be able to do so, it called upon the Commission to present a Euro 5 proposal by the end of 2004. These fiscal incentives would be applied to diesel vehicles that fulfil certain PM limit values².

France announced on 21 June 2004 its national plan on health and environment (2004-2008)³. According to this plan France envisages fiscal incentives to reduce the emission of particulate matters through the promotion of the use of particulate filters or technologies that have equivalent performance.

The Dutch authorities notified on 7 October 2004 under Directive 98/34/EC a draft proposal which foresees fiscal incentives for diesel vehicles that emit not more than 5 mg/km PM⁴.

Representatives of the Austrian and Swedish governments have informed the Commission services that their governments are equally interested in introducing fiscal incentives for motor vehicles that comply with certain requirements for the PM emissions.

3. Legal Situation

Directive 98/69/EC of the European Parliament and of the Council of 13 October 1998 relating to measures to be taken against air pollution by emissions from motor vehicles and amending Council Directive 70/220/EEC lays down limit values for emissions from passenger cars and light duty vehicles (so called Euro 4), which have to be complied with according to a timetable set out in its Article 2.

Article 5 of Directive 98/69/EC allows for tax incentives which “comply in advance with the mandatory limit values”. According to Article 5 “Member States may make provision for tax incentives only in respect of motor vehicles in series production which comply with Directive 70/220/EEC, as amended by this Directive. Such incentives shall comply with the provisions of the Treaty and [...] apply to all new series-production vehicles offered for sale on the market of a Member State [...] they shall not exceed the additional cost of the technical

² See Presse und Informationsamt der Bundesregierung, Pressemitteilung Nr. 290, 07.06.2004 and Bundesministerium für Umwelt, Naturschutz und Reaktorsicherheit, Pressemitteilung Nr. 216/04, 13.07.2004.

³ Plan national santé-environnement (2004-2008), 21 juin 2004.

⁴ Notification 2004/395/NL. Text available on the following webpage: <http://europa.eu.int/comm/enterprise/tris/>

solutions introduced to ensure compliance with the values [...] and of their installation on the vehicle”.

As is explained in Recital 20 to Directive 98/69/EC, Article 5 is meant to allow “Member States [...] by means of tax incentives, to expedite the placing on the market of vehicles which satisfy the requirements adopted at Community level, such incentives having to comply with the provisions of the treaty and satisfy certain conditions intended to avoid distortions of the internal market”.

A notification system is also foreseen, whereby “the Commission shall be informed in sufficient time of plans to institute or change the incentives referred to in the first subparagraph [of Article 5], so that it can submit its observations”.

The Community legislator has thus chosen to lay down a number of rules for tax incentives that anticipate the introduction of the obligatory emission limits mentioned in Article 2 of Directive 98/69/EC. In other words, Article 5 provides for tax incentives that lose their *raison d’être* once the obligatory emission limits introduced by the Directive apply.

As a consequence, Member States are not prevented by Directive 98/69/EC from applying tax incentives for vehicles fulfilling more stringent standards, which satisfy at the same time the limit values of the Directive.

It is only when a new Directive is adopted regulating the introduction of new more stringent standards and fiscal incentives for meeting these standards in advance of any legal obligation (i.e. future Euro 5), that the Member States would have to comply with this harmonized approach and abandon any other tax incentives linked to the type approval.

The obligatory emission limits introduced by Directive 98/69/EC will apply as of 1 January 2005. From that date and for as long as a new Directive has not been adopted, Member States can apply tax incentives for vehicles fulfilling more stringent standards, than those set out in Directive 98/69/EC.

However, when doing so they have to respect certain obligations. In terms of formal requirements Member States have to respect the notification obligations under Directive 98/34/EC⁵ of the European Parliament and of the Council of 22 June 1998 laying down a procedure for the provision of information in the field of technical standards and regulations.

According to Article 8 of this Directive technical regulations have to be notified at a draft stage. Technical regulations include so called *de facto* technical regulations which are *inter alia* “technical specifications or other requirements [...] which are linked to fiscal or financial measures affecting the consumption of products [...] by encouraging compliance with such technical specifications or other requirements” (article 1, point 11, second subparagraph, third indent).

Technical specifications which are linked to fiscal or financial measures affecting the consumption of products by encouraging compliance with such technical specifications constitute *de facto* technical regulations and have to be notified to the Commission (which subsequently circulates them to all Member States) at a draft stage according to Article 8 of this Directive.

⁵ OJ L 204, 21.07.1998, p. 37, as amended by Directive 98/48/EC, OJ L 217, 05.08.1998, p. 18.

Therefore, Member States wishing to put into force as of 1 January 2005 fiscal incentives for vehicles fulfilling more stringent standards, than those set out in Directive 98/69/EC, have to notify to the Commission the technical specifications linked to the fiscal incentives under Directive 98/34/EC.

The Commission and each Member State have the right to issue comments on the notified technical specifications, which according to Article 8 of Directive 98/34/EC the notifying Member State “shall take [...] into account as far as possible”. Furthermore, the Commission and each Member State also have the right to issue a so called detailed opinion where the measure envisaged may create obstacles to the free movement of goods within the internal market.

With regard to fiscal incentives such comments or detailed opinions may, however, only concern aspects “which may hinder trade [...] and not the fiscal or financial aspects of the measure” (Article 8, point 1, last paragraph).

The fiscal incentives that Member States may envisage for vehicles fulfilling more stringent limits have to comply with the rules of the EC Treaty, in particular Article 90, which prohibits any discrimination through internal taxation, in particular by favouring the sale of vehicles of domestic manufacture⁶.

Furthermore, Member States will have to carefully assess in how far the foreseen fiscal incentive has been structured in such a way that it could qualify as state aid under Article 87 of the EC Treaty. For example, should the measure be selective in that it provides an advantage to a certain operator it would be considered state aid. Member States are being reminded of their obligation to notify the Commission in sufficient time of any plans to grant state aid under Article 88(3) of the EC Treaty. Specific community guidelines on state aid for environmental protection have also been issued⁷.

Finally, the Commission services would like to draw attention to the fact that in its Communication on taxation of passenger cars in the EU the Commission set already out that “a gradual transfer of revenue should take place from registration taxes to annual circulation taxes”⁸, as this would provide more fiscal stability for Member States budgets, given that the registration tax is subject to the fluctuation in vehicle sales. Furthermore, registration taxes tend to constitute a disproportionate burden on the acquisition of a car, while annual road taxes distribute the burden over the useful life of the car. Differentiation in the level of annual circulation taxes favouring the owners of vehicles that comply with strict environmental standards have proven to be an efficient means to steer the demand towards environmentally friendlier vehicles in a number of Member States.

⁶ See e.g. Case C-113/94, ECR 1995 I-4203; Joined Cases 76, 86 to 89 and 149/87, ECR 1988, 2397; Case 433/85, ECR 1987, 3521.

⁷ OJ C 37, 03.02.2001, p. 3.

⁸ Communication from the Commission, Taxation of passenger cars in the European Union – options for action at national and Community levels, COM(2002) 431 final, 06.09.2002, section 4.

4. Euro 5 – Work underway

The Commission services are currently developing the future Euro 5 emission limit values. Euro 5 will be proposed in the form of an amendment to Directive 70/220/EEC⁹. The Sixth Environmental Action Programme (6EAP)¹⁰ sets a long term objective of "achieving levels of air quality that do not give rise to significant negative impacts on and risks to human health and the environment"¹¹. Moreover, the 6EAP calls for the development of a Thematic Strategy on air pollution and the adoption of appropriate measures concerning particulate matter and ozone in order to attain the objectives of the 6EAP¹². The Clean Air For Europe (CAFE) programme aims to provide the technical basis for the preparation of the Thematic Strategy¹³. CAFE will look at emissions, current and future air quality and the costs and benefits of further measures to improve air quality. On this basis, the Commission will identify those measures which are required in order to attain the necessary air quality levels. Euro 5 will be one among several such measures.

One of the main issues that will be addressed under Euro 5 are particulate matters (PM) and nitrogen oxide (NOx) emissions from diesel vehicles. The Commission had already set out in its review of the Auto-Oil II Programme¹⁴, as well as in its Communication on the Clean Air for Europe (CAFE) programme¹⁵ that PM and ozone¹⁶ constitute key remaining challenges in terms of air quality policy with regard to road transport.

The Council supported in its Conclusions of 18-19 December 2000 on the review of the Auto-Oil II Programme "the opinion put forward in the Commission communication concerning the need for further action on particulate matter, nitrogen oxides and tropospheric ozone"¹⁷. The Council invited the Commission to "make continued efforts to significantly reduce nano-particulate emissions", and to "give consideration to the need to bring the provisions on limit values for diesel engines – for example, on emissions of nitrogen oxides – closer to the provisions for petrol engines". The Commission services have sent out a questionnaire on Euro 5 to the stakeholders with different scenarios, including PM emission limit values, which will be assessed for the purpose of the Euro 5 proposal.

With regard to motor vehicles, the Commission services acknowledge that the reduction of pollutant emissions may lead to higher CO₂ emissions. The Commission services will, therefore, study carefully the evidence of knock-on effects of the future Euro 5 limit values on the CO₂ targets. Should such knock-on effects be confirmed, they would be taken into account in the framework of the CO₂ voluntary commitments.

⁹ Council Directive 70/220/EEC of 20 March 1970 on the approximation of the laws of the Member States relating to measures to be taken against air pollution by gases from positive-ignition engines of motor vehicles, OJ L 76, 06.04.1970, p.1, several times adapted and amended, last time through Commission Directive 2003/76/EC of 11.08.2003, OJ L 206, 15.08.2003, p. 29.

¹⁰ Decision 1600/2002/EC of the EP and Council

¹¹ Article 7(1)

¹² Article 7(2)

¹³ "The Clean Air For Europe Programme - Towards a Thematic Strategy for Air Quality", COM(2001) 245 final

¹⁴ COM(2000) 626 final, 05.10.2000.

¹⁵ COM(2001) 245 final, 04.05.2001.

¹⁶ Ground-level ozone is formed in the atmosphere by the reaction of pollutants such as NOx and volatile organic compounds (VOCs) in the presence of sunlight.

¹⁷ 2321st Council meeting, Environment, Brussels, 18 and 19 December 2000.

5. Indications for fiscal incentives

As mentioned in the introduction (see point 1. above), information that is at this stage available to the Commission services shows that all those Member States that want to introduce fiscal incentives linked to low levels of pollution, wish to apply them to diesel passenger cars and small (class I) light duty diesel cars based on certain PM emission limit values. This is why the Commission services have decided to limit these indications to PM emissions from these vehicle classes.

In devising a provisional limit value, the starting point must be the limit of 25 mg/km PM from 1 January 2005 as laid down in Directive 98/69/EC. Progress in reducing particulate emissions from diesel cars indicates that today a much lower level can be reached if particulate filters are fitted to diesel cars. While the EU does not intend to favour a particular technology, it must take the latest state of technological development into account when establishing limit values for vehicle emissions. This is at present the diesel filter, but of course any other technology achieving the same result should be admitted. Legislation for vehicle emissions – including measures of the Member States for the purpose of granting fiscal incentives – should be technology-neutral.

At the same time, the nature of the EU limit values needs to be kept in mind. Unlike average values that are used in certain parts of the world, the EU fixes limit values that every vehicle needs to respect¹⁸. Vehicle manufacturers must *de facto* construct their vehicles in such a way that they undercut the legally prescribed limit values in order to be sure that their vehicles fulfil the legal requirements in view of some variation due to the manufacturing process, in-use compliance, a certain deterioration over time and test repeatability and reproducibility. The engineering target must thus be set sufficiently below the legal limit value.

Based on these considerations the Commission services suggest that those Member States that intend to introduce fiscal incentives base these on the following PM limit value for diesel passenger cars and small (class I) light duty diesel vehicles:

5 mg/km

This is a reduction of 80% compared to the current limit value of 25 mg/km PM for diesel passenger cars and small (class I) light duty diesel vehicles that will become mandatory as of 1 January 2005 under Directive 98/69/EC (i.e. Euro 4). According to knowledge currently available to the Commission services this implies an engineering target of 2.5 mg/km.

The Commission services consider that this value is both realistic from a technical point of view, as well as justified from a cost benefit point of view. At the present state of technological development, it appears that a value of 5mg/km or below can only be met if diesel cars are equipped with particulate filters.

The Commission services would like to underline that this value may be used by the Member States as from 1 January 2005 for the purpose of granting fiscal incentives for low-polluting

¹⁸ Section 7 of Annex I of Council Directive 91/441/EEC of 26 June 1991 amending Directive 70/220/EEC on the approximation of the laws of the Member States relating to measures to be taken against air pollution by emissions from motor vehicles OJ L 242, 30.08.1991, p. 1 and subsequent amendments.

vehicles. It does, therefore, not prejudge those limit values that the Commission will propose in its formal Euro 5 proposal in 2005.

In this context, it has to be mentioned that concerns have been raised by the automotive industry regarding the feasibility of ensuring that low limit values are met throughout the whole life-time of a vehicle. The Commission services will, therefore, examine in view of the formal Euro 5 proposal whether in-use requirements and durability requirements will have to be modified.

Finally, it must be underlined that Member States are obliged to grant type approval also to vehicles that do not fulfil the limit values required for benefiting from fiscal incentives, but that do fulfil the emission requirements set out under Directive 98/69/EC.

6. Conclusions

The Commission services suggest that Member States base their fiscal incentives aiming at supporting low-polluting vehicles on the PM value indicated in this paper.

The Commission services consider that the use of a higher or a lower limit value than the one provided herewith, would potentially lead to a fragmentation of the Internal Market.

The Commission services would like to underline that the formal Euro 5 proposal will provide a longer time horizon, given that the future Euro 5 limit values are not supposed to become mandatory before 2010.

Therefore, when using the PM level indicated in this paper, Member States have to bear in mind that it is aimed at facilitating an early introduction of such fiscal incentives based on a uniform EU-wide value as of 2005.

In other words fiscal incentives that will be based on the PM value set out in this paper may have to be modified, when the final Euro 5 limit values will have been adopted by the European Parliament and the Council.