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Proposal for a

COUNCIL IMPLEMENTING DECISION

**authorising the United Kingdom to apply reduced levels of taxation to motor fuels
consumed on the islands of the Inner and Outer Hebrides, the Northern Isles, the islands
in the Clyde and the Isles of Scilly, in accordance with Article 19 of Directive
2003/96/EC**

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

Taxation of energy products and electricity in the Union is governed by Council Directive 2003/96/EC¹ (hereafter referred to as the ‘Energy Taxation Directive’ or the ‘Directive’).

Pursuant to Article 19(1) of the Directive, in addition to the provisions foreseen in particular in its Articles 5, 15 and 17, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce further exemptions or reductions in the level of taxation for specific policy considerations.

- **Reasons for and objectives of the proposal**

The objective of this proposal is to allow the United Kingdom of Great Britain and Northern Ireland (UK) to continue applying a reduced rate of excise duty on motor fuels (namely unleaded petrol and gas oil) in all the islands of the Inner and Outer Hebrides, the Northern Isles, the islands in the Clyde (all off the coast of Scotland), and the Isles of Scilly (off the south west coast of England). According to the information provided by the UK the price of fuel in the areas which are to benefit from the measure is on average GBP 0,10 (app. EUR 0,12) more per litre than in other parts of the country. Higher prices in these areas are due to higher transport and distribution costs, and low population. The objective of the measure is to offer some mitigation against the high costs of motor fuels in the specified areas.

Article 19(1) of the Directive envisages that the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce further exemptions or reductions in the level of taxation for specific policy considerations.

Council Implementing Decision 2011/776/EU authorised the United Kingdom to apply, until 30 October 2017, reduced levels of taxation to unleaded petrol and gas oil used as motor fuels in certain islands. By letter dated 16 September 2016 and additional information sent on 16 December 2016, under Article 19 of the Directive, the UK authorities asked the Commission to prolong the application of the reduced rate. The reduced rate of the excise duty on fuel will be GBP 0,05 (app. EUR 0,06) per litre lower than the standard rate in the UK (GBP 0,58 or app. EUR 0,67)². This would mean that the reduced rate would still be far above the current EU minimum per 1 000 litres of EUR 359 for unleaded petrol and EUR 330 for gas oil.

The UK has requested for the reduction to be authorised for a period of six years, which is the maximum period indicated in Article 19(2) of the Directive.

According to the UK authorities, the price of fuel in the Scottish islands is around GBP 0,10 (app. EUR 0,12) per litre higher than the average for the rest of the UK. A GBP 0,05 (app. EUR 0,06) per litre reduction would not cover the full price difference, but would provide consumers with some compensation for the higher price which they have to bear.

The higher price is caused by the additional costs of selling fuel in these regions. The UK authorities indicate two key reasons for these higher costs:

- (1) Higher transport and distribution costs to deliver fuel to the islands, caused by extra shipping / truck transportation costs (longer distance and time), ferry costs, terminal operation costs and supplier premiums associated with the delivery of low volumes

¹ Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for taxation of energy products and electricity, OJ L 283 of 31.10.2003 p. 51.

² The UK applies the same excise duty rate to petrol and gas oil used as motor fuel. EUR 674 per 1000 l, (information from July 2016)

of fuel. In contrast, almost all mainland areas of England and Wales are within 100 miles (app. 160 km) of at least one refinery and can be served directly by road tankers. Transport costs to the Scottish islands are estimated to be at least GBP 0,03 per litre higher than on mainland Scotland.

- (2) The low population served (103 801 people aged 16 or over across 100 islands) and low volume of fuel sold per site means that fixed costs need to be spread across a small volume of sales. To put this in context: there are 70 fuel filling stations in total in these areas. Fixed costs for staff, rent, rates, heat, light, water, maintenance and repair must be factored into the final pence per litre pump price. The average volume of fuel sold per site on the Shetlands, Orkneys and Hebrides varies between 0,25 and 0,6 million litres a year, compared with 3,8 million litres for the rest of Scotland. In order to cover costs of running a fuel station, sales of 0,25-0,6 million litres would require a margin of GBP 0,07-0,15 per litre compared with a margin of GBP 0,033 per litre on sales of 3,8 million litres.

The disadvantage represented by the higher prices induced by the increased per unit cost is important for the local population, according to the UK authorities, because many of the residents have to travel significant distances by motor vehicles to reach their nearest urban centre, as they often depend on private transport and because the areas benefiting from the measure are relatively low income areas.

Operation of the measure

In the UK, excise duty on motor fuels is charged at the point when the fuel leaves the refinery, when it is imported or when it leaves an excise warehouse. At this point it would be difficult to identify the amount of fuel destined for eligible regions.

Therefore, the relief will be given at the point of sale on the eligible islands, thus avoiding any risk arising from diversion of reduced rate fuel. Fuel retailers on the islands would be registered with HM Revenue and Customs (HMRC) as approved retailers and would be required to reduce the price of a litre of fuel by the amount of the duty relief. They would in turn be entitled to claim a refund of duty from HMRC, on a periodic basis, based on the litres of fuel sold.

Scope

The territorial scope of the measure consists of all the islands of the Inner and Outer Hebrides, the Northern Isles, the islands in the Clyde (all off the coast of Scotland); and the Isles of Scilly (off the south west coast of England). The measure is aimed at all purchases, both private and commercial will benefit from the lower tax rate. According to the information provided by the UK authorities of those vehicles licensed in the islands in 2016, 86 % were privately owned and 14 % were company owned.

Arguments of the UK authorities concerning the impact of the measure on the internal market

The UK authorities do not think that the measure would affect the proper functioning of the internal market. The largest organisations on the islands are public sector bodies such as local councils and health service providers. There is a wide spread of companies on the islands, but they tend to have lower turnover than on average across the UK. According to the UK authorities, companies in the areas concerned have average turnover of around GBP 1,4 million compared with a UK average of around GBP 5,7 million.

The United Kingdom underlines that the relief does not cover the full cost differential between the islands and the UK mainland so it would be uneconomic for people to travel to the islands from the mainland to take advantage of the special scheme.

Moreover, according to the United Kingdom, undertakings benefitting from the measures represent only small competitors in the markets in which they operate.

Existing provisions in the area of the proposal

Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

- **Consistency with existing policy provisions in the policy area**

Assessment of the measure under Article 19 of Directive 2003/96/EC

Specific policy considerations

Article 19(1), first subparagraph, of the Directive reads as follows:

"In addition to the provisions set out in the previous Articles, in particular in Articles 5, 15 and 17, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce further exemptions or reductions for specific policy considerations."

The measure envisaged by the UK consists in reducing excise duty on motor fuels supplied in certain parts of its territory namely all the islands of the Inner and Outer Hebrides, the Northern Isles, the islands in the Clyde (all off the coast of Scotland), and the Isles of Scilly (off the south west coast of England). The aim is to bring pump prices in these territories closer to the UK average. The higher per unit costs and thus pump prices in these areas are due to higher transportation and distribution costs and lower economies of scale.

It can be concluded that the wish to apply a reduced excise duty rate on motor fuels in the areas concerned on account of their specific geographical conditions is based on specific policy considerations.

- **Consistency with other Union policies**

The aim of the measure is to partly counterbalance the higher per unit cost, and thus pump prices, of fuel in the islands concerned, through a direct duty relief at the point of sale.

The measure is limited to what is needed to this effect. In particular, the relief is confined to the (relatively small) amount of fuel sold on the islands.

Moreover, the amount of the relief remains below the additional costs of selling fuel in these regions and, by the same token, below the difference between the fuel prices applied there and those applied on the mainland.

In this regard, the Commission notes that the excise duty rate will be reduced by GBP 0,05 per litre of product. Yet, according to the information provided by the United Kingdom authorities, the additional transportation costs for the territories covered are GBP 0,03 per litre higher than the UK average, and the costs of running gas stations are estimated to be higher resulting in price of approximately GBP 0,07 to 0,15 per litre, compared to the UK average of GBP 0,033 per litre.

As a result, the fiscal incentive to use energy efficiently is maintained at a level at least equal to the one prevailing on the mainland.

Finally, despite the relief, the tax burden borne by fuel consumed in the geographic areas concerned will remain well above the minimum levels of taxation set out in Directive 2003/96/EC.

The measure is compatible with the health, environment, energy and transport policies of the Union.

Under the circumstances described, it also appears acceptable in view of the proper functioning of the internal market and the need to ensure fair competition. In particular, due to the insular nature of the areas to which it applies and the moderate reduction in the rate, it is not expected that it will lead to changes in fuel consumption, through the attraction of consumers from outside these areas.

After the reduction envisaged by the UK authorities, the level of taxation on unleaded petrol and gas oil in the regions concerned will still respect the minimum level of taxation pursuant to Article 7 of Directive 2003/96/EC. Provided that the measure respects the conditions laid down in Article 44 of the General Block Exemption Regulation (EC) No 651/2014/EU³, as well as the general condition laid down there-in, the measure falls within the scope of that Regulation and is, by consequence, exempt from the prior notification requirement.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

Article 19 of Council Directive 2003/96/EC.

- **Subsidiarity (for non-exclusive competence)**

The field of indirect taxation covered by Article 113 of the Treaty on the Functioning of the European Union is not in itself within the exclusive competence of the EU within the meaning of Article 3 of the Treaty.

However, pursuant to Article 19 of Directive 2003/96/EC, the Council has been granted an exclusive competence, as a matter of secondary law, to authorise a Member State to introduce further exemptions or reductions within the meaning of that provision. Member States cannot therefore substitute themselves for the Council. As a result, the principle of subsidiarity is not applicable to the present implementing decision. The proposal therefore respects the principle of subsidiarity.

- **Proportionality**

The proposal respects the principle of proportionality. The tax reduction does not exceed what is necessary to attain the objective in question.

- **Choice of the instrument**

Instrument proposed: Council Implementing Decision.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Ex-post evaluations/fitness checks of existing legislation**

The measure does not require the evaluation of existing legislation.

- **Stakeholder consultations**

This proposal does not require any stakeholder consultations; it is based on a request made by the United Kingdom and concerns only this Member State.

- **Collection and use of expertise**

There was no need for external expertise.

³ Commission Regulation 651/2014/EU declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, pp. 1–78).

- **Impact assessment**

This proposal concerns an authorisation for an individual Member State upon its own request and does not require an impact assessment.

- **Regulatory fitness and simplification**

The measure does not provide for a simplification. It is the result of the request made by the United Kingdom and concerns only this Member State.

- **Fundamental rights**

The measure has no bearing on fundamental rights.

4. BUDGETARY IMPLICATIONS

The measure does not impose any financial and administrative burden on the EU. The proposal therefore has no impact on the EU budget.

5. OTHER ELEMENTS

- **Detailed explanation of the specific provisions of the proposal**

Article 1 - The United Kingdom will be allowed to continue applying a reduced rate of excise duty on motor fuels (namely petrol and gas oil) in all the islands of the Inner and Outer Hebrides, the Northern Isles, the islands in the Clyde (all off the coast of Scotland), and the Isles of Scilly (off the south west coast of England).

The level of taxation after reductions can never be lower than the EU minima set in Directive 2003/96/EC and the reduction would apply for everyone in these region.

The measure would help the disadvantaged regions to mitigate the higher costs of fuel due to insular geographical location of the islands.

Article 2 - The authorisation requested is granted with effect from 1 November 2017 for a period of six years, as requested by the United Kingdom.

Since the United Kingdom notified on 29 March 2017 its intention to leave the Union, pursuant to Article 50 of the Treaty on European Union, the Treaties will cease to apply to the United Kingdom from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification, unless the European Council, in agreement with the United Kingdom, decides to extend that period. As a consequence, and without prejudice to any provisions of the withdrawal agreement, this Council decision only applies until the United Kingdom ceases to be a Member State.

Proposal for a

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authorising the United Kingdom to apply reduced levels of taxation to motor fuels consumed on the islands of the Inner and Outer Hebrides, the Northern Isles, the islands in the Clyde and the Isles of Scilly, in accordance with Article 19 of Directive 2003/96/EC

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity⁴, and in particular Article 19 thereof,

Having regard to the proposal from the European Commission,

Whereas:

- (1) By letter of 16 September 2016 the United Kingdom requested authorisation to apply a reduced rate of excise duty on gas oil and unleaded petrol pursuant to Article 19 of Directive 2003/96/EC on the islands of the Inner and Outer Hebrides, the Northern Isles, the islands in the Clyde (all off the coast of Scotland); and the Isles of Scilly (off the south west coast of England). The United Kingdom provided additional information on 16 December 2016.
- (2) In these areas, the prices of gas oil and unleaded petrol are higher than the average prices in the rest of the territory of the United Kingdom, placing local fuel consumers at a disadvantage. The price difference is due to additional per unit costs induced by the geographic location of the islands, their low population numbers and the delivery of relatively low volumes of fuel.
- (3) The tax reduction will not exceed what is necessary to compensate for the additional per unit costs borne by the consumers in the geographical areas concerned.
- (4) The reduced excise duty rates will be above the minimum rates laid down in Article 7 of Directive 2003/96/EC.
- (5) In view of the insular nature of the areas to which it applies and the moderate reduction in the rates, the measure will not give rise to additional driving specifically linked to the supply of motor fuel.
- (6) Consequently, the measure is acceptable from the point of view of the proper functioning of the internal market and of the need to ensure fair competition and it is compatible with the European Union's health, environment, energy and transport policies.
- (7) It follows from Article 19(2) of Directive 2003/96/EC that each authorisation granted under this Article must be strictly limited in time. In order to provide the businesses

⁴ OJ L 283, 31.10.2003, p. 51.

and consumers concerned with a sufficient degree of certainty, the authorisation is granted for a period of six years. This decision is without prejudice to the application of the Union rules regarding State aid.

- (8) Since the United Kingdom notified on 29 March 2017 its intention to leave the Union, pursuant to Article 50 of the Treaty on European Union, the Treaties will cease to apply to the United Kingdom from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification, unless the European Council, in agreement with the United Kingdom, decides to extend that period. As a consequence, and without prejudice to any provisions of the withdrawal agreement, this Council decision only applies until the United Kingdom ceases to be a Member State,

HAS ADOPTED THIS DECISION:

Article 1

The United Kingdom is hereby authorised to apply reduced levels of taxation to unleaded petrol and gas oil used as motor fuel in all the islands of the Inner and Outer Hebrides, the Northern Isles, the islands in the Clyde and the Isles of Scilly.

The reduction from the national level of taxation for unleaded petrol or gas oil respectively shall be no greater than the additional cost of retail sales in these geographical areas, compared with the average cost incurred of retail sales in the United Kingdom and shall be no more than GBP 50 per 1 000 litres of product.

Article 2

This Decision shall be applicable from 1 November 2017 and shall expire on 31 October 2023.

Article 3

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels,

*For the Council
The President*