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IMPLEMENTATION OF THE COMMUNITY LISBON PROGRAMME
COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE
EUROPEAN PARLIAMENT

The Contribution of Taxation and Customs Policies to the Lisbon Strategy

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The Contribution of Taxation and Customs Policies to the Lisbon Strategy

1. A NEW START FOR THE LISBON STRATEGY

The Commission has recently proposed a new start for the Lisbon strategy, with the focus on growth and jobs.¹ In order to meet this challenge, it will be necessary to make Europe a more attractive place in which to invest and work; to promote knowledge and innovation; and to shape policies that allow European businesses to create more and better jobs.

Taxation and customs policies have a significant role to play in the attainment of these objectives. They can contribute to raising the efficiency of our economies, including via the efficient use of natural resources, and the competitiveness of our companies. They can also generate more competition in the markets, boost trade and support knowledge and innovation.

This Communication presents the **key Community taxation and customs policy measures** that would contribute to the rapid structural adjustment needed in our economies in order to fulfil the above objectives. In so doing, it follows the lines of action established in the Communication to the Spring European Council: "Working together for growth and jobs, a new start for the Lisbon strategy"².

The purpose of this Communication is to set out in a comprehensive manner both ongoing and planned customs and tax measures that represent a coherent set of initiatives supporting one of the main EU political commitments.

Section 2 presents key actions aimed at deepening the internal market, ensuring open and competitive markets and improving European and national legislation. Section 3 presents key initiatives to increase and improve investment in research and development and to facilitate innovation and the sustainable use of resources. (See the annexed table of policy measures). In the light of their specific features, these initiatives will take different form and will, as appropriate, be accompanied by an evaluation of their impact.

These initiatives would help to renew growth and therefore create more and better jobs. As far as more specific employment policies are concerned, it should be noted that, at Member State level, specific taxation measures can contribute to raising employment and promoting socially inclusive economies. Relatively heavy taxation on labour appears to have been a disincentive to the creation of additional jobs, especially low skilled jobs; but broadening the tax base by getting more people in work is still the most effective way for governments to raise revenues without raising tax rates. A shift from labour to consumption and/or pollution taxes could also help as part of a broader strategy to increase employment levels.

¹ Commission, COM(2005) 330 and COM(2005) 24.

² *ibid.*

1.1. Taxation, efficiency and competitiveness

While some degree of tax competition is healthy and can have positive economic effects, the main objective of any tax system is to raise a certain amount of revenue in order to finance public services and transfers. This should be done as effectively as possible. Tax systems can entail costs either in the form of reduced economic efficiency — due to tax distortions — or through compliance and administrative burdens on tax payers and tax administrations.

The existence of different national tax systems in the EU represents a sizeable source of extra cost in terms of administrative tax compliance. This situation implies barriers to a more efficient allocation of resources and a lack of a "level playing field"³. In fact, double taxation, tax-related business restructuring costs and more general differences between Member States' tax rules mean that firms may prefer to operate domestically rather than in another Member State. These are significant obstacles to achieving the full benefits of **a competitive internal market**. The removal of these barriers would help create new opportunities for market entrants, and the resulting competition would spur investment and innovation. Moreover, the reduction in costs associated with the removal of these tax barriers would contribute to enhancing the competitiveness of the EU productive sector.

Taxation policy could also have a proactive role in boosting **knowledge and innovation for growth**. Research and development as well as the general business environment could benefit from targeted fiscal measures. Taxation could also help to promote environmental change leading to more sustainable patterns of production and consumption.

1.2. Customs policy, one of the pillars of the Internal Market

Customs policy has an important role to play in **boosting trade**. The increase in trade volume in recent years, along with the complexity of the modern supply chain, security and safety concerns, the number of parties involved and the speed with which goods are exchanged, greatly increases the requirements concerning trade-related information.

Simplified customs legislation, streamlined customs processes and procedures and the creation of a coherent and interoperable electronic customs system will mean that traders will save money and time in their business transactions with customs. At the same time, computerisation and interoperability will ensure traceability of goods and transparency for both customs administrations and the business community.

2. MAKING EUROPE A MORE ATTRACTIVE PLACE TO INVEST AND WORK

2.1. Extending and deepening the Internal Market

The Lisbon strategy stresses that key reforms are still needed to complete the internal market and that these should be given specific attention. The bulk of the action taken by the EU in the field of taxation policy addresses issues related to the establishment and functioning of the internal market. In this context, it is worth stressing the important contribution that the Community Programmes Customs 2013 and Fiscalis 2013⁴ will continue to provide to the smooth functioning of the Internal Market, not least through their funding of the electronic interconnection of Member States' informatics systems in the field of customs and taxation.

³ See "European Tax survey" (SEC(2004) 1128/2).

⁴ Commission, COM(2005) 111.

At present, **several aspects of the functioning of national tax systems have negative effects on market integration** or prevent the advantages of a single market from being fully exploited. Moreover, because the current business environment is more conducive to cross-border activities than was the case two decades ago, taxation obstacles are now more evident as remaining barriers in the internal market.

The removal of such obstacles would allow businesses to make sounder economic choices that are based on the productivity of factors and are less distorted by the influence of certain extra costs. This would lead to an increase in the output of the economies of Member States and, depending on the conditions of the relevant product markets and the actual behaviour of firms, downward pressures on costs and prices. This, in turn, would result in welfare gains.

2.1.1. A Common Consolidated Corporate Tax Base for EU businesses

The present co-existence of 25 different and sometimes even mutually incompatible **corporation tax systems** in the EU *de facto* imposes supplementary compliance costs and offers few opportunities for cross-border loss compensation, even though such loss compensation frequently exists for purely domestic situations. This should not happen in a truly single market. While in their commercial activities (research, production, inventories, sales, etc.) companies increasingly tend to treat the EU as one single market, they are obliged, for tax purposes alone, to segment it into national markets.

Corporate tax rules treat cross-border activities in the EU differently and frequently less favourably than similar purely domestic activities. This encourages firms to invest domestically and deters participation in foreign companies and the establishment of subsidiaries abroad. At the same time, inconsistencies between national systems open possibilities for tax avoidance.

The Commission policy of working towards a **Common Consolidated Corporate Tax Base** ("CCCTB") dates back to 2001⁵ and was confirmed in 2003⁶. A CCCTB would enable companies operating in the internal market to follow the same rules for calculating their tax bases in different Member States of the EU. The Commission does not intend to propose a harmonised corporate income tax rate. However, a Common Consolidated Corporate Tax Base would permit cross-border offsetting of losses and would solve the current tax problems linked to cross-border activities and restructuring of groups of companies. A method for sharing the consolidated tax base between Member States so that each State could apply its own tax rate to its share of the consolidated base would have to be agreed. This method should lead to a simpler and more transparent corporate tax system in the EU.

This is a challenging exercise, but the Commission intends to carry out the necessary preparatory work towards a Common Consolidated Tax Base during the next three years in order to present a Community legislative measure by 2008.

2.1.2. Simplifying the tax environment and creating a level playing field

The measure presented above aims at tackling many of the Corporate tax obstacles faced by multinational companies. However, cross-border economic activities in the EU are also confronted with a number of other taxation measures, particularly in the VAT system, that impose cumbersome obligations and act as barriers to trade and investment. Cross-border

⁵ Commission, COM(2001) 582 and SEC(2001) 1681.

⁶ Commission, COM(2003) 726.

activities lead to statistically significant increases in compliance costs for all companies⁷. Small and medium-sized enterprises are particularly vulnerable to such obstacles since compliance costs are proportionately higher for SMEs than for large companies, and relief from these obstacles could considerably increase SMEs' participation in the internal market, that is at present much lower than that of large companies. This results in economic inefficiencies and a potentially negative impact on economic growth and job creation.

a) VAT compliance obligations

According to the European Tax Survey⁸, the reason that 14% of SMEs and 10% of large companies have not carried out economic activities subject to VAT in Member States where they do not have permanent establishments is solely because of VAT compliance requirements. In response to this, in October 2004 the Commission presented a major proposal to **simplify current cross-border VAT compliance obligations** so as to make life easier for traders who supply goods and services to other EU Member States. In particular, the proposal provides for a “**one-stop shop**” system which would allow traders to use a single VAT number for all supplies throughout the EU and to make a single global VAT declaration to an electronic portal, through which the return would be submitted automatically to the different Member States where the trader has taxable activities. The proposal contains five other simplification measures that should make it much easier for businesses, especially SMEs, to trade in other Member States. Discussions are ongoing in the Council.

b) Experimental application of the Home State Taxation approach

In the context of the Commission's company tax strategy, the concept of Home State Taxation was identified as a possible solution for those tax issues which hamper SMEs most in their cross-border activities. Essentially, the Home State concept applies the internal market **approach of mutual recognition to the corporate tax treatment of SMEs**. Qualifying companies would apply the corporate tax rules of their residence state to subsidiaries and permanent establishments in other participating Member States. This would not imply any harmonisation of rates as these would continue to be set and applied by each Member State.

The Commission is of the opinion that this idea, which has been developed in considerable technical detail, could usefully be tested by allowing SMEs to use the approach on an experimental, pilot-scheme basis for five years. The Commission intends to present a Communication on this subject before the end of 2005.

c) VAT rules concerning international services

Tax legislation addresses economic realities and is only efficient if it is continuously adapted to new developments and challenges. The fact that more and more services can be supplied internationally is a particular challenge. While the EU has been able to react successfully to the implications for VAT of e-commerce and the liberalisation of telecommunication services, the VAT rules determining the place of supply for other services capable of delivery from a remote location need to be changed in a similar way so as to ensure that operators within and outside the EU are on an equal footing and so as to guarantee that revenue is allocated to the country of consumption.

⁷ See "European Tax Survey (SEC(2004) 1128/2).

⁸ SEC(2004) 1128/2.

The Commission presented a proposal as regards the **place of supply for services between taxable persons (B2B)** in 2003.⁹ This proposal has recently been amended in order to include the **review of the place of supply rules for services from business to consumer (B2C)**.¹⁰ The amended proposal should, when adopted, ease the VAT burden for businesses supplying cross-border services to other businesses by eliminating additional VAT registration requirements and eliminating the need for costly refund procedures. It will also help to overcome distortions of competition caused by the application of different VAT rates by different Member States (and for which further rate harmonisation is unlikely) and to create a level playing field with third country operators.

d) VAT rules concerning financial services

The **VAT rules on financial services** date from 1977 and provide a general exemption for that sector. This means that VAT paid by financial institutions on their inputs is, in general, not deductible and thus becomes a final cost for financial institutions. A cascade effect is created with the result that the cost of services to business clients is increased. The situation may become even more complicated when the financial institutions outsource part of their activities and such supplies are made subject to additional VAT. There is good evidence that this exemption system is fundamentally inefficient and increases costs.

There is a **need to review these rules** as they are an increasing source of tension. Furthermore, the rules lend themselves to differences in interpretation at national level. These outdated VAT measures are increasingly at odds with other Community policy objectives such as the Financial Services Action Plan. Unintended consequences of the VAT rules are frequently an impediment to the increased efficiency in the sector which could otherwise be expected as a result of the creation of a single pan-European marketplace for financial services.

The Commission intends, after a broad consultation process with all stakeholders, to present a legislative proposal to adapt the VAT financial services rules to the evolution of the single financial market.

e) Public authorities competing with private business

The rules governing the exemptions of services in the public interest and the **exclusion of public bodies from the scope of the application of VAT** will also need modernising. The current rules are outdated and no longer correspond to the economic reality of the 21st century, where former monopolies have been subjected to liberalisation processes and broad areas of public services have been partially or totally privatised. This is causing distortions of competition and economic inefficiencies and is encouraging tax avoidance schemes. The Commission intends to amend the current VAT rules by making a proposal by the end of 2006 to re-establish a level playing field in certain activities in which both public and private entities are involved.

2.1.3. Targeted measures to remove cross-border tax barriers faced by EU firms

In the area of **corporate taxation**, the Commission has, pending the implementation of the CCCTB, identified several targeted solutions aimed at removing single tax barriers.

⁹ Commission, COM(2003) 822.

¹⁰ Commission, COM(2005) 334.

a) Cross-border loss relief

The lack of **cross-border loss relief** tends to impact on business decisions by inciting companies either to invest domestically or to make cross-border investments in larger Member States, due to the greater likelihood that they already have a tax base there against which losses may be set off.

Whereas cross-border losses within one company, i.e. losses of a foreign permanent establishment, may be taken into account at the level of the head office in most Member States, only a few Member States provide for cross-border setting-off of losses within a group of companies, i.e. allowing relief for the losses of a foreign company belonging to the same group. It is obvious that such a difference in treatment creates distortions.

Following the withdrawal of a 1990 proposal for a directive dealing with this issue, the Commission has commenced technical discussions with Member States with a view to presenting a Communication soon after the European Court of Justice has delivered its judgement in case C-446/03 ("Marks & Spencer"), which should be particularly relevant in this area.

b) Transfer pricing

The management of **transfer pricing** is a considerable source of additional compliance costs for EU firms.¹¹ The Commission established the EU Joint Transfer Pricing Forum in 2002 in order to find pragmatic, non-legislative solutions to transfer pricing problems in the EU. It consists of tax experts from Member States' tax administrations and from the business world. Following the Forum's first report the Commission adopted a Communication, including a proposal for a Code of Conduct for the effective implementation of an Arbitration Convention in 2004,¹² and the Council agreed to this Code of Conduct last December.

Following the Forum's second report of May 2005, the Commission intends this year to propose a Code of Conduct on a common approach to transfer pricing documentation for associated enterprises in the EU. In addition, the Commission services and Forum members are now focusing their attention on alternative procedures for the avoidance and elimination of tax disputes.

c) Capital duty

Certain indirect taxes such as **capital duty** (a levy on contributions of capital to capital companies) are clearly detrimental to businesses within the EU and should be abolished as part of the process of making Europe a more attractive place in which to invest. The levying of capital duty is particularly damaging in connection with restructuring operations and the development of EU companies. It is also disadvantageous for companies starting up and for companies increasing their capital. In recent years, the trend has been towards an elimination of capital duty. This duty is currently levied by just 10 of the 25 Member States. And from next year only 8 Member States will continue to levy it.

Therefore, the Commission services are now preparing a proposal for a recast of the Capital Duty Directive¹³ before the end of 2006. The recast will aim to simplify and modernise the

¹¹ See "European Tax Survey" (SEC(2004) 1128/2).

¹² Commission, COM(2004) 297.

¹³ Council Directive 69/335/EEC of 17 July 1969 as amended.

legislation and to provide for a phasing out of capital duty with a view to supporting the development of EU companies.

2.1.4. A new strategy for car taxation

The European **car market** is a good example of a sector that **has not yet benefited fully from the internal market**, and taxation is one of the reasons for this. Following a Communication in 2002¹⁴ and an extensive consultation process, the Commission adopted on 5 July 2005 a new proposal on passenger car taxation¹⁵. This proposal calls for the **gradual abolition of car registration taxes in Member States and their replacement by annual circulation taxes or other existing or innovative new taxes**. The gradual abolition of registration taxes would reduce bureaucracy and the high transactional costs faced by consumers. It would also bring about more transparency and legal certainty for all operators and reduce existing car price differentials by about one fifth.

The proposal also aims to reduce the existing fragmentation of the EU car market, which affects the cross-border car trade. At present, industry is often obliged for tax reasons to produce specific models with different specifications for different Member States. The proposal would give an impetus to the car industry to benefit from greater economies of scale by producing cars for the entire internal market using the same technical specifications.

2.1.5. Reducing distortions created through tax fraud and tax evasion

Tax fraud creates a significant distortion in the functioning of the internal market, prevents fair competition and also erodes revenues that should be used for the implementation of public services at national level. Increased levels of fraud result in increased tax burdens on legitimate companies as governments are forced to make up their revenue shortfalls.

The operation of tax systems is and should remain the competence of Member States. Nevertheless, the Commission believes that more common and coordinated approaches could help and encourage Member States in the fight against tax fraud. The Commission is therefore currently evaluating the need for a new anti-fraud tax policy at European level. A wide range of instruments could be considered, such as improving cooperation between internal administrations; reducing obstacles to the effective exchange of information by, for example, improving access to bank information; promoting negotiations with third countries to introduce provisions for exchanging information; further developing the use of intra-Community administrative cooperation tools; and improving basic tax legislation.

The Commission would ensure the necessary coordination, in particular with a view to enhancing the administrative cooperation tools available to Member States. It intends to present a Communication on this subject in 2006.

2.2. Ensuring open and competitive markets inside and outside Europe

European companies are facing an increasing number of international challenges. Ensuring a level playing field for them within and outside the EU would enhance investment in the EU's internal market. Action to improve the international competitiveness of EU firms is therefore essential in order to meet the Lisbon agenda.

¹⁴ Commission, COM(2002) 431.

¹⁵ Commission, COM(2005) 261.

2.2.1. *A strategy against counterfeiting*

The industrial and intellectual property rights of EU businesses are being massively violated by **pirated and counterfeit products**. According to studies carried out by the International Chamber of Commerce in 1997 and the OECD in 1998:

- Counterfeits accounted for 5 to 7% of world trade
- Counterfeits were responsible for the loss of 200 000 jobs in Europe

Since that time there has been considerable growth in this traffic. In 2003 in Davos, Switzerland, global business leaders and Government representatives called for "a massive global effort to combat counterfeiting, now estimated to equal more than 450 billion dollars annually". Improving border controls was considered to be of key importance.

EU customs seizures (more than 100 million articles a year, with a value of over €1 billion) have increased by almost 1000% in the last five years. All EU business sectors face increasing competition from this illegal and unfair trade. This trade also reduces tax yields and puts at risk the safety of citizens.

Effective action to protect intellectual property rights is necessary if investment in research and development is to be encouraged and a level playing field inside and outside the EU is to be ensured.

A coherent strategy based on practical measures to give business low-cost and concrete support to combat this threat calls for solid intervention at Community level. International cooperation will also need to be promoted so as to stop the production and export of fakes in source countries. Without this underpinning safety net, businesses will face an increasingly unfair struggle against new producing regions manufacturing fakes on an unprecedented scale.

After having presented in July a comprehensive package of criminal measures aimed at ensuring the enforcement of intellectual property rights¹⁶, the Commission adopted a Communication in October 2005¹⁷ setting out concrete measures designed to increase the protection that customs authorities can offer against piracy and counterfeiting, namely through an enhanced partnership with economic operators and an increased international cooperation with the EU's trading partners.

2.2.2. *Improving customs legislation and customs compliance, and promoting eCustoms*

In the current international business environment, simple, predictable and cost-effective formalities for the cross-border movement of goods have become central to increasing economic growth through national or regional participation in international trade. Furthermore, customs authorities are very well placed to ensure that imports respect environmental, health and technical requirements, and that commercial policy measures are efficiently enforced. This part of customs work is crucial to ensuring that

* a level playing field is created, maintained or re-established with trade partners,

¹⁶ Commission, COM(2005)276

¹⁷ Commission, COM(2005)479

* trade-sensitive consumer goods produced in the EC can obtain the full benefits that should be associated with their production standards and location, and

* defensive measures, where required to cushion necessary adjustment in the EC, are effective.

In 2003, the Commission adopted a Communication on a simple and paperless environment for customs and trade and the role of customs in the integrated management of external borders.¹⁸ The latter sets out an action plan for a thorough revision of customs procedures including their simplification and streamlining in order to make full use of the possibilities offered by information and communication technologies (ICT). Presentation at the customs is a mandatory step in the movement of goods across the Community's external borders. The procedures to be applied significantly influence the role of domestic industry in international trade and its contribution to the domestic economy. Effective and efficient clearance of goods increases the participation of domestic industry in the global marketplace, contributes to its competitiveness, and encourages the participation of small and medium-sized enterprises in international trade while meeting security challenges. Moreover, by streamlining and adapting customs legislation, procedures and processes, including common standards for IT systems, a **modernised Customs Code**, combined with operational actions in the Member States, will contribute to achieving a simple and paperless environment for customs and trade.

This modernised Customs Code, which will be the subject of a Commission proposal later this year, will be the legislative pillar of eCustoms. It will create the legal basis for electronic data exchange not only between traders and customs authorities of the Member States', but also with other administrations or agencies involved in the international movement of goods, as provided for in Commission Communication on the role of eGovernment for Europe's future.¹⁹ According to this initiative, traders will have to deliver information only once to customs authorities, ('single window') and the goods will be controlled by these different authorities at the same time and at the same place ('one-stop shop').

In order to permit effective and efficient risk management, the customs administrations of all Member States must be able to exchange electronic information. This includes in particular the exchange of pre-arrival and pre-departure declarations, risk information and information concerning economic operators. Therefore, customs systems and practices will need to be convergent, and the automated customs systems of the Member States and of the Commission will need to be synchronised. In addition, traders will need to communicate and carry out their business with customs online. This should be achieved on the basis of the principle of "inclusive access" (multi-platform access), as defined in the above-mentioned Commission Communication on the role of e-Government for Europe's future.

2.3. Improving European and national regulation

2.3.1. Modernising VAT rules

Better regulation is an important element of the renewed Lisbon strategy. In the area of **VAT**, the Commission has made **several proposals** aimed at improving the regulatory framework so as to remove obstacles to market functioning and to introduce more competition.

¹⁸ COM(2003) 452.

¹⁹ Commission, COM(2003) 567.

The basic VAT legislation laid down in the 6th VAT Directive has undergone numerous modifications and has become complex and difficult to understand. The Commission has therefore proposed a **recast of the 6th VAT Directive**²⁰ in order to provide clear EU-level rules for traders wishing to do business in the EU. The discussions on this proposal have progressed significantly in the Council and will be continued with a view to its adoption before the end of 2005.

In addition, it has becoming increasingly apparent that there is a need for a more uniform application of the VAT system in order to facilitate the Community-wide activities of businesses. In 2004, the Council provided for the possibility of adopting measures to ensure the uniform implementation of existing VAT rules²¹. The first Regulation proposed²² by the Commission under this new legal basis has recently been agreed by the Council and will be adopted shortly. The Commission considers that a **more extensive use of this possibility to adopt binding secondary VAT legislation** at Community level would go a long way to eliminating the difficulties encountered by businesses confronted with divergent interpretations of EU VAT law.

The need for a more uniform application of VAT rules is particularly evident where different interpretations can lead to **double taxation** (or conversely to non-taxation). Nevertheless, there are also circumstances where cases of double taxation or a requirement for a trader to pay VAT on the same transaction in two different Member States may be due to the fact that Member States have different views of the nature of a particular supply. This different appreciation of facts can result despite the Member States concerned having identical VAT legislation. The Commission will therefore make a proposal by the end of 2005 for an EU mechanism to resolve or at least alleviate such situations of double taxation.

3. KNOWLEDGE AND INNOVATION FOR GROWTH

3.1. Increasing and improving investment in Research and Development (R&D)

Both economic theory and empirical analysis emphasise the key role of R&D in economic growth. R&D investments typically create spill-over effects whereby the social return of the investment is higher than the private return to the company. Hence, without public intervention the level of business research would remain at a sub-optimal level and fail to enhance the full growth potential of the economy.

Accordingly, various measures designed to promote R&D are included in the Lisbon agenda. The Presidency conclusions of the European Council of March 2005 explicitly state that the 3% R&D investment objective "will be obtained *inter alia* by tax incentives for private investment....."

3.1.1. *A Communication providing guidance on R&D tax incentives*

Depending on the economic background, the R&D capacity and the overall tax system in a given country, tax incentives can help to address market failures and increase business research investment by reducing the cost of R&D. Fiscal measures allow firms to better determine the appropriate allocation of R&D investment across projects and priorities and

²⁰ COM(2004) 246.

²¹ Directive 2004/7/EEC.

²² Commission, COM(2004) 641.

offer them greater legal and planning certainty. They also allow creating a direct link between public incentives and increase in private R&D spending, which is crucial given the average lack of private research and innovation in Europe. However, the value of R&D tax incentives has to be assessed in the context of the overall tax system. For instance, the level of overall corporate tax rates decisively influences the impact of tax incentives in connection with the level of business R&D investment.

In recent years, Member States have introduced a variety of different R&D fiscal incentives or have reinforced existing ones. Over the last two years, an exchange of information among Member States on the best practices in this domain has been overseen by CREST as part of the mutual learning process aimed at increasing the level of R&D investment. Currently, however, there is a great diversity of R&D incentives in Member States which creates a largely uncoordinated situation at the EU level. Given that Member States are often confronted with the same types of challenges, this lack of coordination can result in sub-optimal allocation of public resources and is an obstacle to an EU-wide level playing field.

A Communication providing guidance on R&D tax incentives could help to tackle this relative failure and ideally help Member States jointly develop solutions to common problems and even devise mutually reinforcing R&D incentives, thus creating a favourable tax environment for R&D in the EU research area. In line with the announcement made in its State Aid Action Plan, in 2006 the Commission will review its framework for State aid in favour of R&D and innovation. In parallel, a Communication offering guidance to Member States on how to design and implement measures on R&D tax incentives in their general taxation system will be presented to provide them in particular with a clear view of the relevant constraints in Community law.

The Communication will:

- set out the key EU legal conditions for Member State R&D tax incentives;
- highlight best practices as regards R&D tax treatment and incentives in some Member States that could serve as a model for other Member States; and
- where appropriate, set out the political message and main contents of possible future initiatives directed to Member States.

Clearly, such a Communication will be designed to help those Member States who wish to use tax incentives but would in no way oblige Member States to use them.

3.2. Facilitating the sustainable use of resources

Indirect taxation, as a market-based instrument, can play a significant role in the sustainable use of resources in the European Union. Appropriately designed excise duties or specific environmental charges provide improved price signals by internalising external environmental costs, and thus lead economic actors to change their behaviour accordingly. Moreover, taxation provides incentives to companies to pursue technological innovation to reduce their tax burden. Energy, transport and environmental taxes could be used to facilitate such sustainable use of resources, preferably in a coordinated EU framework in order to avoid distortions of competition.

3.2.1. Energy, transport and environment-related taxes

The Energy Products Taxation Directive²³ has given Member States new scope for using taxes in order to facilitate the sustainable use of resources. For instance, it allows tax reductions for companies which implement agreements leading to the achievement of environmental protection objectives or to improvements in energy efficiency.

a) Taxation of commercial diesel

This Directive requires amendment, however, in order to tackle the **distortion of competition on haulage markets** created by wide divergences in the levels of taxation of commercial diesel in EU Member States. While the recent screening exercise relating to pending legislation has led to the withdrawal of the proposal of 2002²⁴ concerning commercial diesel, the Commission intends, before the end of 2005, to present a new proposal taking into account the comments made by the European Parliament, the Council and operators during the debates on the initial proposal.

b) Energy taxation

In addition, the Commission is considering whether to propose changes to the Energy Tax Directive to introduce **more ambitious environmental targets for energy taxation** aimed at full internalisation of external costs. In the 2005 Green Paper on Energy Efficiency²⁵, the Commission has stated that further initiatives need to be considered with a view to strengthening the positive impact of taxation policies in favour of greater energy efficiency. These include, for instance, bringing excise rates on energy products and electricity consumed in production activities closer together, but at the higher end of the scale, and introducing automatic indexing of all excise rates.

c) Car taxation

Moreover, it should be noted that the newly adopted car tax proposal referred to in section 2.1.4 above also includes provisions for the introduction of a CO₂-sensitive element into the tax base of Member States' car tax provisions. Fiscal measures constitute one of the three pillars of the Community strategy to **reduce CO₂ emissions from passenger cars**. Their optimal use, together with commitments from the car industry and consumer information, is critical in achieving the Community's target of 120 g CO₂ per km. The reduction in CO₂ emissions would go hand in hand with savings in the energy consumption of cars, which would in turn contribute positively to the efficient use of energy products and the sustainability of energy supplies.

²³ Directive 2003/96/EC (OJ L283 of 31.10.2003, p.51), as last amended by Directive 2004/75/EC (OJ L157 of 30.04.2004, p.100)

²⁴ COM(2002) 410.

²⁵ COM(2005) 265.

ANNEX

Lisbon Strategy: Key Taxation and Custom Policy Measures already adopted or under consideration

Making Europe a more attractive place to invest and work	Knowledge and innovation for growth
<i>1. Extending and deepening the internal market</i>	<i>1. Increasing and improving investment in R&D</i>
<ul style="list-style-type: none"> • A Common Consolidated Corporate Tax Base for EU businesses (2008); • Simplifying the tax environment and creating a level playing field: VAT compliance obligation: one stop shop, (2004); home state taxation, (2005); VAT rules international services and financial services (2005), (2006); VAT public bodies, (2006); • Targeted measures to remove cross-border tax barriers faced by EU businesses: cross-border loss relief, (2006); transfer pricing, (2005); capital duty, (2006); • A new strategy for car taxation (2005); • Reducing distortions created through tax fraud and tax evasion (2006). 	<ul style="list-style-type: none"> • A Communication providing guidance on R&D tax incentives (2006).
<i>2. Ensuring open and competitive markets inside and outside Europe</i>	<i>2. Facilitating the sustainable use of resources</i>
<ul style="list-style-type: none"> • A strategy against counterfeiting (2005); • Improving customs legislation with a view to promoting e-Customs (2005). 	<ul style="list-style-type: none"> • Energy, transport and Environment-related taxes: taxation of commercial diesel, (2005); energy taxation, (2006); car taxation, (2005).
<i>3. Improving European and national legislation</i>	
<ul style="list-style-type: none"> • Modernising VAT rules (2005). 	