Tax Obstacles for the Development of an Effective Euro-Mediterranean Free-Trade Area: an IFTA model for the European Union?

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Abstract

As we know, the European Union has faced the challenge of harmonization in the tax field with varied results. We may think that the advanced harmonization in indirect taxes (custom duties, VAT and excise duties) has reduced the distortions that they may create in the intra-EU commerce. Far from this assumption, in the paper we will underline how the lack of a complete harmonization may create competitive advantages in certain countries and sectors.

Specifically, we will examine how the road haulage sector is affected by the differences in diesel excise duties among Member States. The proposal for a Euro-Mediterranean Free-Trade Area would face the same problems as the European Union. If there are distortions inside the European Union, the extension of the free trade area to other mediterranean countries would possibly worsen it. This is why we suggest the establishment of a system equivalent to the IFTA (International Fuel Tax Agreement), existing in the United States and Canada, in order to achieve an efficient haulage system free of tax distortions.

Key words:
excise duties, diesel, fuel tourism, IFTA, tax harmonization
1. The harmonization of fuel taxation in the European Union

The full achievement of the single market raises the need to remove a number of tax obstacles, purpose for which the European Union started, since its very first moment, a process of gradual integration of Member States tax systems that has been known as tax harmonization. The gaps in this harmonization process are the origin of tax arbitrage situations lead by the agents looking for a reduction in their tax bill. This connection is intensified if such lack of harmonization affects the bases with greater mobility.

As the Neumark reports remarked back in 1962, the main risk for a common market is an asymmetrical system of indirect taxation because it may hinder the free movement of goods, services and even citizens. For this reason, the Neumark report, fifty years ago, laid the groundwork for the common system of VAT and the establishment of minimum levels of taxation for specific goods including tobacco, alcohol, and fuel.

With regard to fuel taxation the harmonization began with directives 92/81/EEC and 92/82/EEC, which were almost exclusively confined to the harmonization of structures and rates of excise duties on mineral oils. The harmonization in rates was limited to the set of minimum rates per 1,000 liters of fuel, allowing State members (and so did them) to increase the rates with no limits.

Soon the Commission became aware of the need to provide a minimum tax to other energy products, including electricity, in order to limit emissions of CO2,. This concern, expressed for the first time in the Proposal for a Council Directive Restructuring the Community Framework for the Taxation of Energy Products (COM (97) 30 final, of 17 March 1997) finally crystallized later in Directive 2003/96/EC, which extended the fixing of minimum rates to electricity, natural gas and coal in addition to increase the minimum taxation on fuel as we can see in the following table:

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Table 1: Minimum fuel excise duties (€) in each EU Directive

<table>
<thead>
<tr>
<th>Directive 92/82</th>
<th>Leaded petrol</th>
<th>Unleaded petrol</th>
<th>Diesel</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>337</td>
<td>287</td>
<td>245</td>
</tr>
<tr>
<td>Directive 2003/96</td>
<td>421</td>
<td>359</td>
<td>330</td>
</tr>
</tbody>
</table>

We can verify that diesel enjoys a much more advantageous tax treatment than petrol. This difference would be justified, in principle, by the lower CO2 emissions of this fuel. However, as the Commission pointed out in 2007, apart from CO2, diesel emissions of other pollutants almost treble the unleaded petrol ones. This is why, the Commission criticizes that “from an environmental point of view, there is no reason why diesel fuel should be taxed at a lower level than petrol”\(^2\).

With the aim of aligning the taxation on both type of fuels, the Comission issued a Proposal for a new Council Directive in the field of energy taxation\(^3\) which, in regards to fuel, would rise the minimum rate on diesel up to 412 euros per 1000 litres in 2018 (even above unleaded petrol). The rejection of many States to this Directive was bases in the huge impact in diesel prices that this increase would have, affecting the road haulage sector (as this is the fuel used by lorries). The relevance of this sector for the economy and the risk of inflation due to the increase in shipping costs have stopped, for the moment, the approval of this new Directive.

2. Current diesel excise duties in the European Union, main differences

Through the following graphs we will try to show a picture of current diesel excise duties in the European Union. In the first graph we have selected some


representative Member states, analyzing the evolution of their diesel excise duties in the last 10 years.

At first glance we can verify that States like Spain and Luxembourg still maintain the minimum taxation set by the Directives. Germany, did not change its excise duties either, although it has kept higher levels of taxation. Most recent Member States like Latvia have adapted quite fast to the minimum levels of taxation and nowadays have higher levels than many EU-15 countries. It is striking the sharp increase of Italy excise duties on diesel in the recent years (obviously looking for funds in order to fight the current crisis) which have positioned it close to United Kingdom that still maintains the higher diesel excise duties in the European Union.

The differences among states are significant. The fix of minimum rates are useless to reduce this gap\(^4\) as long as countries like Italy or United Kingdom keep taxation levels that are more than twice the minimum rates.

**Graph 1 – Excise duties on diesel – € / 1.000 litres – 2004-2013**

![Graph 1](chart.png)


In the following map we can check out the differences of consumer diesel prices among State members (VAT included):

Graph 2 - Consumer Diesel Price (VAT included) €/ Litre - 2014

The previous map is quite useful to create a couple of comparative tables with the differences in diesel price among adjacent and non adjacent Member states, the keystone to understand the tax arbitrage (fuel tourism) dinamics in the European Union.

Table 2 – Diesel Price Differences between Member States cts. €/ Litre - 2014

<table>
<thead>
<tr>
<th>Adjacent MS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>IT-FR</td>
<td>31</td>
</tr>
<tr>
<td>IT-SI</td>
<td>31</td>
</tr>
<tr>
<td>IT-AT</td>
<td>31</td>
</tr>
<tr>
<td>BE-LU</td>
<td>20</td>
</tr>
<tr>
<td>DE-LU</td>
<td>18</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-Adjacent MS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>UK-LU</td>
<td>45</td>
</tr>
<tr>
<td>IT-LU</td>
<td>44</td>
</tr>
<tr>
<td>DK-LU</td>
<td>29</td>
</tr>
<tr>
<td>NL-LU</td>
<td>23</td>
</tr>
</tbody>
</table>


3. The problem of fuel tourism in the European Union

As the Commission has already pointed out, fuel (including taxes) represents up to 30% of the running costs of a road haulage business. If we take into account that diesel excise duties represents between 35% and 60% of the pump price of diesel fuel

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we can estimate that diesel excise duties are more than 10% (an up to 18%) of the running costs of a road haulage business.

The born of a liberalised market and the great differences in diesel excise duties among Member States has encouraged fuel tourism between road haulage operators. The reason, as the Commission explained, is simple:

"big trucks have tanks of huge capacity, which allow them to cover between 1,500 and 3,000 kilometres on a single tank. That means in reality that hauliers involved in international activities or located near the border of a low taxing country conduct a kind of fiscal planning, known as fuel tourism: they take advantage of the very significant differences in national excise duties on gas oil fuel by filling up in Member States with the lowest taxes".

This tax planning has three negative consequences. First of all, it distorts the competition in haulage markets because not all the operators have access to low taxed diesel. In the second place, it has negative consequences on the environment due to the detours that rational operators do in order to buy the cheapest fuel. Finally, we should bear in mind the budgetary losses for the Member States that see how lorries use their roads but do not pay their taxes since they have already filled the tank somewhere else.

The statistics and studies are hopeless. Luxembourg is the best example of the capacity of attraction of fuel tourism in the world. According to World Bank statistics (2010), the per capita diesel consumption of the small Grand Duchy of Luxembourg is 3,240 kgs a year. Three times more that the next country in the world (Qatar) and 8 times the average of the European Union.

Then, Luxembourg has become a diesel haven to road haulage operators thanks to it is privileged geographical position, in the middle of the main transport routes in Europe, and it is minimum diesel excise duties.

It is obvious that one of the main pillars for the development of an Euro-Mediterranean Free-Trade Area has to be the road haulage sector. Well, due to the geography of the European Union, the most possible ways of entrance of goods from North Africa will be the ports of South Europe (Spain, Italy, Greece, etc.). In order to develop an optimal free trade area the goods should go through the most efficient channel in terms of time and cost. In fact, the logic would suggest that both criteria,
time and cost, should be directly correlated. However, as we could see before, the impact of taxation affects this equation, distorting the channels of road haulage inside Europe.

The Commission documented these distortions with an example of two lorries which load in different ports: Hamburg (Germany) and Anterp (Belgium), and make the same trip in order to unload at the port of Nuremberg (Germany). The possibility of passing through Luxembourg creates a competitive advantage in favour of Belgian ports against German ones of more than 6,000 euros a year. If we do not look for solutions the same problem may recur if we expand the free trade area to Mediterranean countries.

4. The IFTA model: is it possible for the European Union?

The solution we suggest in this paper is the development of a system in the European Union equivalent to the one existing in the United States and Canada in order to neutralise the competitive distortions of diesel excise duties differences among States.

Specifically, we are talking about the IFTA (International Fuel Tax Agreement), an agreement signed in 1991 among 48 States of United States and 10 Canada provinces. Through this instrument they have delegated in the IFTA, Inc. (International Fuel Tax Association) the management of a coordinated taxation system on fuel. The objective of the mechanism is that every carrier pay taxes according to the excise duties set in each state and depending on the distance they have traveled in each state. How does it work?

Carriers that are going to do interstate tours must register in the state of its headquarters and install and adapted GPS that keep up-to-date records of their itineraries. On a quarterly basis, the carrier must make a statement which shall contain the distance travelled in each state, data that will allow them to estimate the total amount of fuel consumption in each state by an average of total consumption and

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The average consumption (galons per mile) is then multiplied by the values of the excise duty on fuel (mostly diesel) in each State according to the official data published by the IFTA inc. Thus, we obtain the tax due in each State by each carrier. Once it has been calculated they will detract the tax effectively paid in their refuelling, so there will be States to which the carrier will pay more taxes and others in which they will be entitled to a refund.

Debtor and creditor balances in each state are offset each other in the quarterly statement of the carrier. Finally, there is a unique balance, positive or negative; representing the amount that the carrier will have to pay (or receive) to the IFTA Inc. Internally, IFTA will send to each participating state or province the corresponding balance of its territory.

The advantages of the system created by the IFTA are evident: it neutralises any chance of fuel tourism among road haulage operators in the United States and Canada.

Once we have arrived here there is one obvious question: is it possible that the European Union could develop a similar system? Up to now, the serious distortions to competition caused by fuel tourism has just received a timid response through a couple of proposals focused on advances in the harmonisation of rates.

If there is political will, we have no doubt that the European Union can create a system like IFTA at European level, assumming the functions of IFTA Inc. Once we have checked that there are not technological or logistical impediments to use this kind of mechanism, we only face one main problem: the require of unanimity in the Council for every single step forward in tax harmonisation. It is not difficult to imagine one (small) country that will refuse, for sure, the implementation of this system. Here we face again the eternal dilemma between "what is" (and will be) and "what should be".