BRIEFING

EU Legislation in Progress

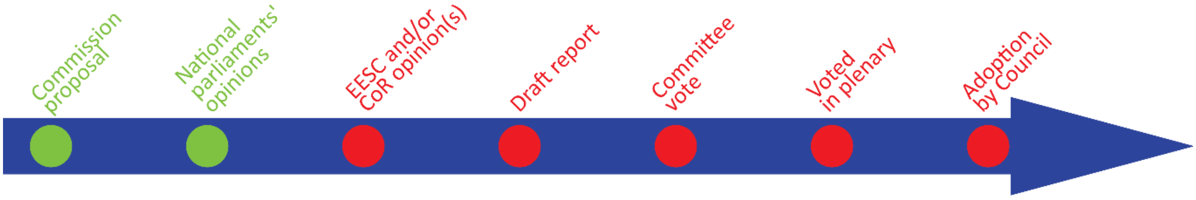
Revision of the Energy Taxation Directive: Fit for 55 package

OVERVIEW

The revision of the Energy Taxation Directive (ETD) is part of the 'fit for 55' package. The current ETD (Directive 2003/96/EC) is outdated and out of sync with the EU's climate and energy objectives. It favours the use of fossil fuels and no longer contributes to the proper functioning of the internal market. The aspects of energy taxation requiring most urgent revision are the level and structure of minimum rates, replacement of the volume-based approach to energy taxation with one based on energy content and environmental performance, and the introduction of an indexation mechanism. The effectiveness of the current directive is further limited by outdated coverage of energy products, specifically biofuels, and a series of tax differentiations, reductions and exemptions.

In July 2021, the Commission presented a proposal for the revision of the Energy Taxation Directive. Its objective is to align the taxation of energy products with EU energy and climate policies by promoting clean technologies, removing outdated exemptions and reducing rates that *de facto* encourage the use of fossil fuels. The ETD revision is a consultation procedure. It requires unanimity in Council, after consulting the European Parliament and the European Economic and Social Committee. Parliament has assigned the file to the Committee on Economic and Monetary Affairs, which appointed a rapporteur in September 2021. The ITRE committee is associated with the procedure under Rule 57.

Proposal for a Council Directive restructuring the Union framework for the taxation of energy products and electricity (recast)		
Committee responsible:	Economic and Monetary Affairs (ECON)	COM(2021)0563 14.7.2021
Rapporteur:	Johan Van Overtveldt (ECR, Belgium)	2021/0213(CNS)
Shadow rapporteurs:	Georgios Kyrtsos (EPP, Greece) Joachim Schuster (S&D, Germany) Ondřej Kovařík (Renew, Czechia) Claude Gruffat (Greens/EFA, France) Gunnar Beck (ID, Germany) José Gusmão (The Left, Portugal)	Consultation procedure (CNS) – Parliament adopts a non-binding opinion only
Next steps expected:	Publication of draft report	



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Introduction

Taxation is still largely a Member State competence. When it comes to tax rates, EU legislation only sets harmonised minimum rates of taxation in order to avoid market distortions. The Energy Taxation Directive 2003/96/EC (ETD) lays down structural rules and sets out minimum excise duty rates for the taxation of energy products used as motor fuel and heating fuel, and for electricity. Its original aim was to ensure that the EU's single market for energy could operate smoothly, and prevent distortions of trade and competition that could result from differences in national tax systems.[1] Member States are free to set their own rates as long as minimum rates are respected. Indeed, the majority of Member States tax most energy products and, in some cases electricity, considerably above the ETD minimum rates.

Energy markets and technologies in the EU have experienced many significant changes since 2003. The EU's international commitments and its policy objectives in the area of energy have changed as its climate action ambition has grown. However, the current ETD does not make a connection between the minimum tax rates of fuels and their energy content or environmental impact and does not reflect the EU's climate and energy policy frameworks. In its current form, the ETD aligns neither with the EU's legal commitment to an at least 55 % reduction in greenhouse gas (GHG) emissions[2] by 2030 compared with 1990 levels, nor with the EU's objective of achieving climate-neutrality by 2050. The European Climate Law enshrines these goals in EU law.

In the context of the European Green Deal, the initiative for a revision of the ETD is part of the 'fit for 55' package. The Commission's July 2021 proposal for revision of the ETD (COM(2021) 563 final) aims to introduce improvements and simplification in the tax rates and taxable base. It also aims to:

- ensure coherence with the emissions trading system (ETS) and avoid inconsistencies and overlaps;
- improve the EU internal market by updating the scope and the structure of rates;
- rationalise the use of tax exemptions and reductions by Member States; and
- preserve the capacity to generate revenues for the budgets of the Member States.

Existing situation

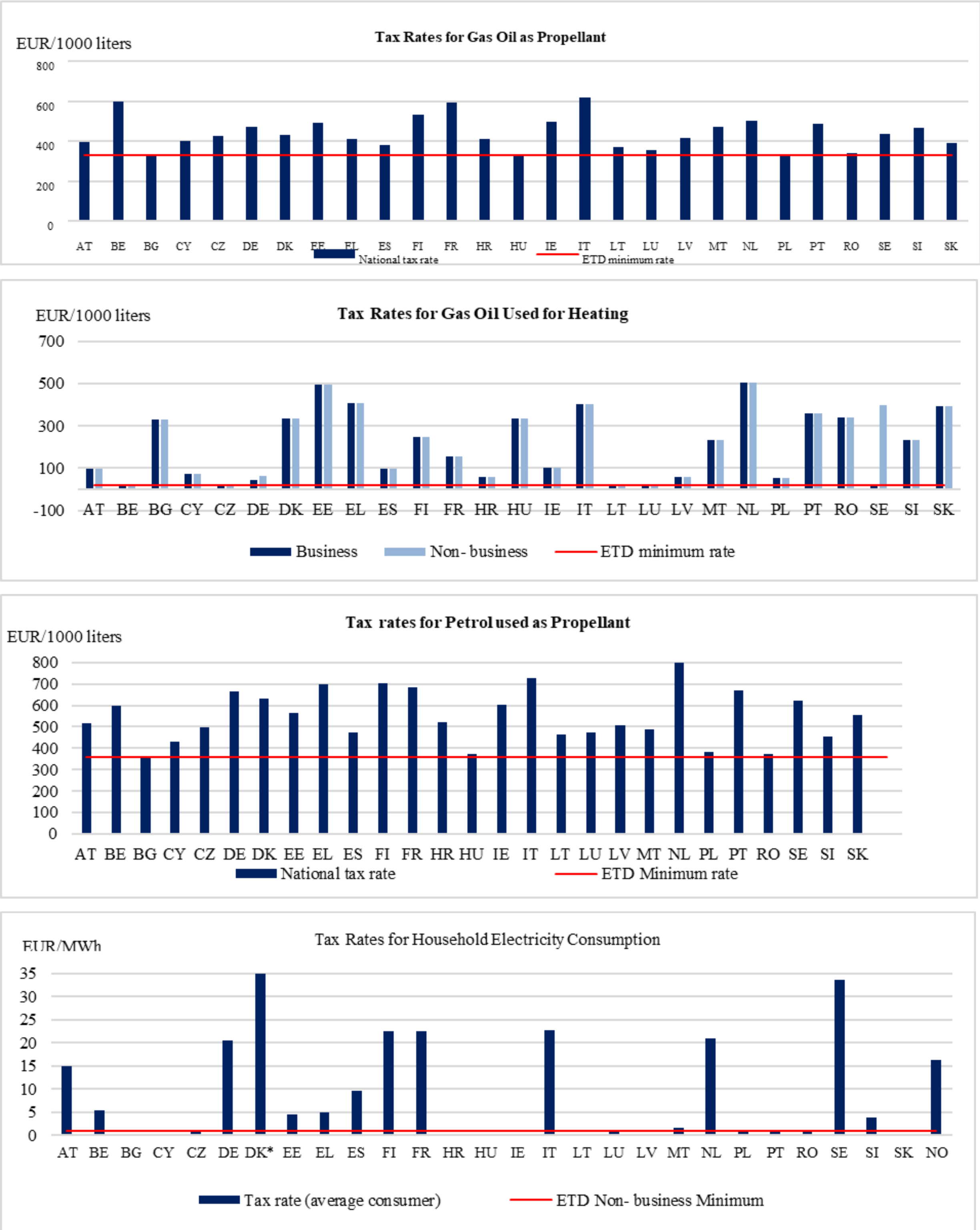
Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity (ETD) entered into force in October 2003 and Member States had to comply with its requirements from 1 January 2004 onwards.

Under this framework, Member States can introduce additional taxes for environmental purposes and, under certain conditions, apply exemptions or reduce tax levels. The harmonised rules set under the ETD include mandatory and optional exemptions. The mandatory exemptions refer to energy products used to produce electricity and for aviation and sea navigation fuel, while the optional exemptions concern electricity from renewables, for the transport of goods and passengers or for biofuels. Under the ETD, other tax reductions, such as lower tax rates for energy products in agriculture, machinery for building and public works, are optional for Member States but have to be authorised by the Council.

Currently, there is no link in the ETD between the minimum tax rates of fuels and their energy content or environmental impact. It has not kept pace with the development of alternative fuels, such as cleaner and sustainable biofuels and hydrogen. Energy efficiency, cleaner and sustainable alternative fuels, investment and innovation in clean technologies and sustainable energy were not considered in the existing directive.

Article 29 of the ETD provides for periodic examination of the directive by Council, based on a report and, where appropriate, a Commission proposal.[3] The Commission report and consideration by Council must take into account the proper functioning of the internal market, the real value of the minimum levels of taxation and the wider Treaty objectives.

Figure 1 – National tax rates and current ETD minimum rates in 2020[4]



Source: Impact assessment report accompanying the Proposal for a Council directive restructuring the Union framework for the taxation of energy products and electricity (SWD(2021) 641 final).

The role of taxation of energy products and electricity has become more and more important in the area of climate and energy policy. The existing ETD does not take current policy objectives such as decarbonisation of transport and reduction of air pollutant emissions into account.[5] In addition, the exemption of fuels used in international commercial aviation and maritime transport does not contribute to the EU's climate objectives. The current ETD includes exemptions for fossil fuels generating greenhouse gases, such as, for instance, in the civil aviation sector or for international flights.[6] Member States have also introduced other exemptions, with EU authorisation, such as those relating to domestic air and waterway transport of goods, passengers and services.

The Commission presented a first proposal amending Directive 2003/96/EC and restructuring the Community framework for taxation of energy products and electricity in 2011, including an impact assessment (Volume 1 and Volume 2), aiming to align the directive with the energy market and the climate challenge. The 2011 proposal considered the fact that the underlying policy framework had changed radically since 2003 and that concrete and ambitious policy objectives had been set in the areas of energy and climate change for the period up to 2020. The proposal was designed, in part, to tax energy products, reflecting energy content and CO_2 emissions. Member States failed to reach an agreement on the proposal, however, and the Commission withdrew it in 2015.

Council starting position

While the 2011 attempt at revising the ETD ultimately failed, Council did agree to a revision of the ETD in its conclusions of 5 December 2019 on the EU energy taxation framework.

In contrast to other energy and climate legislation, where the ordinary legislative procedure applies,[7] unanimity in Council applies regarding the revision of the ETD.

Parliament's starting position

The European Parliament has been very active in supporting a revision of the ETD to adapt it to the changing reality and needs. In April 2012, Parliament adopted a resolution on the 2011 proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity. The resolution stated that taxation of energy products should be done in a technologically neutral manner, allowing development of new technologies.

In June 2016, the Parliament adopted a resolution on the renewable energy progress report, in which it underlined the significance of the new renewable energy and market design legislation in creating a new framework fit for the development of renewable energies. It also urged the Commission to reform the ETD and the State aid rules preventing effective use of incentives as tax cuts for making the shift from fossil energy to renewable energy.

Parliament's resolution of 25 October 2018 on the deployment of infrastructure for alternative fuels in the EU stated that taxation had a major impact on the price competitiveness of alternative fuels. It pointed out the differing levels of effort, ambition and available funding among Member States and that deployment of alternative fuels fell short of being comprehensive and evenly distributed.

On 10 July 2020, the Parliament adopted a resolution on a comprehensive European approach to energy storage. It called on the Commission to develop an efficient taxation system prohibiting double taxation relating to energy storage projects in its proposal for a revised ETD. It also called on the Member States to abolish double taxation of all kinds.

On 27 April 2021, the Parliament adopted a resolution on more efficient and cleaner maritime transport. It condemned the distortion of competition on the European market between fossil fuels[8] and clean alternative fuels from renewable sources and called on the Commission to address this situation by proposing to restore fair competition rules and apply the polluter-pays principle to maritime transport.

Preparation of the proposal

In August 2017, the Commission launched an evaluation of the Energy Taxation Directive, including a roadmap. A public consultation was carried out from March to June 2018. The Commission published its consultation report in August 2018. Contributions from 20 Member States were received. The business organisations represented the highest share of respondents (81 %) and responses from civil society accounted for 12 %.

In addition, an external study on technical and legal aspects of Council Directive 2003/96/EC was prepared by Deloitte and published in September 2019.

The Commission adopted its communication on the European Green Deal in December 2019. Among the key policies and measures needed to achieve the objectives of the Green Deal, the Commission referred to a revision of the ETD.

According to the 2019 Commission staff-level evaluation of the ETD (SWD(2019) 329 final; 11 September 2019), the absence of an increase in minimum rates at EU level for more than a decade had eroded the tax-induced price signal that was supposed to encourage the convergence objective of the ETD in terms of harmonisation and the internal market. As a result, the national rates had generally been well above the fixed minimum rate (see the above figure).

As some Member States had raised their national taxation levels, there was a risk of growing distortion of competition in the single market and erosion of the tax base in high-taxing countries.[9]

With a view to revision of the ETD, the Commission carried out a new public consultation from July to October 2020 targeting all stakeholders (citizens, non-governmental organisations, businesses, trade associations, national administrations) and all sectors of activity.[10] Most of the stakeholders expressed a favourable opinion of the ETD revision. Ninety per cent of all respondents considered that this should reduce the possibility of favouring fossil fuels through tax reductions and exemptions; should take into account GHG emissions in the definition of rates and should introduce incentives for alternative energy sources. A summary report was published in December 2020. It stated that 551 valid contributions had been received (301 of them from business organisations and associations: 30 % from large companies, 16 % from medium-sized companies, 23 % from small companies and 31 % from micro-organisations).

EPRS published an implementation appraisal for the revision of the ETD in May 2021, stating that the ex-post evaluation of the Commission in September 2019 had revealed significant shortcomings with the current directive and its implementation, such as highly divergent national tax rates across the EU and a wide range of exemptions and reductions applied by Member States[11] as well as a lack of alignment with other EU climate and energy legislation. The vast majority of Member States currently apply tax rates above the minimum rates set by the directive, and 'the minimum tax rates have lost their initial converging effect, intended to avoid competitive distortions in the Union'.

The changes the proposal would bring

While the primary focus of the existing ETD is on internal market objectives, its revision is mainly focused on the environmental impact. The proposal for the revision of the Energy Taxation Directive, presented by the Commission on 14 July 2021, aims to align the taxation of energy products with the EU's energy and climate policies by promoting clean technologies and removing outdated exemptions and reduced rates that could even be encouraging the use of fossil fuels. It introduces a new structure of tax rates based on the energy content and environmental performance of the fuels and electricity and broadens the taxable base by including more products in the scope.

Among the main changes are the following points:

- Fuels will start being taxed according to their energy content and environmental performance rather than according to their volume, helping businesses and consumers alike to make cleaner, more climate-friendly choices.
- Products will be categorised for taxation purposes in a simplified way in order to ensure that the fuels most harmful to the environment are taxed the most.
- Exemptions for certain products and home heating will be phased out. It will no longer be possible to tax fossil fuels below the minimum rates.

- Fossil fuels used as fuel for intra-EU air transport, maritime transport and fishing should no longer be fully exempt from energy taxation in the EU.[12]
- New energy products are recognised, such as hydrogen.

The proposal also includes measures to prevent the double taxation of stored electricity, and a significant limitation on Member States exempting or reducing the rates applicable to energy products, processes and sectors. It also envisages an increase in minimum tax rates to reflect current pricing; and a five-yearly review to keep the ETD up to date. The previous minimum rates were set in 2003 and have never been updated to reflect current prices. The proposed minimum rates will be adjusted to reflect the most recent prices, and will be automatically adjusted annually, based on Eurostat consumer prices figures.

Overall, the proposal is aimed at reducing the harmful effects of energy tax competition and at helping secure revenues for Member States from green taxes. More specifically, it is proposed that the above-mentioned changes should come into effect from January 2023.

The scope of the ETD is being enlarged to include energy products or uses that were not included in the EU's energy taxation framework. Certain reduced rates will remain possible, such as those for electricity or advanced energy products produced from renewables. However, a number of national exemptions and tax reductions will be removed allowing Member States a reduced margin to set rates below the minimum rate for specific sectors.

One of the general objectives of the review of the ETD is to ensure a framework that allows Member States to generate the revenues they estimate necessary in full coherence with the European Green Deal (EGD) objectives and to design their tax systems accordingly. Chapter 6.4 – Impact on energy tax revenues of the impact assessment report (SWD(2021) 641 final) estimates the impact on revenues under each suggested option, based 'on the assumption that Member States will only increase their respective national rates, where needed, to reach the "new" minima in the Directive'.

The impact on Member States will depend on various factors, such as i) the current level of national rates, ii) the national use of exemptions and reductions, iii) the energy mix of the economy, and iv) the sectorial impact of the proposed options.

Advisory committees

In January 2012, the European Economic and Social Committee (EESC) issued a positive opinion on the proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity, before the Commission withdrew the proposal in 2015 after Member States failed to reach an agreement.

The EESC opinion on the July 2021 Commission proposal for revision of the ETD is forthcoming (ECO/565-EESC). The joint rapporteurs are Stefan Back (Employers – Group I / Sweden) and Philippe Charry (Workers – Group II/France).

National parliaments

National parliaments were able to submit reasoned opinions on grounds of subsidiarity until 8 November 2021.

The Czech Senate sent a reasoned opinion considering that the revision of ETD did not comply with the principle of subsidiarity according to Article 5(3) of the Treaty on European Union on several counts. For instance, Member States would not be allowed to set different tax rates for energy products in the same category; the mechanism of automatic indexation of tax levels infringes the Member States' tax powers; the definition of vulnerable households as those below 60 % of the national median disposable income was too rough.

Stakeholder views[13]

The European Confederation of Fuel Distribution (ECFD) mentioned the fact that there were as many tax regimes and exemptions in the EU as Member States and the unfair competition this situation created led to the well-established practice of 'fuel tourism' in cross-border areas.

The Transport & Environment organisation (T&E) noted that this time the EU could not afford to withdraw the proposal as it finally updated an outdated tax framework.

The European Association for Storage of Energy (EASE) made recommendations on the classification and definition of the renewable and low-carbon gases and suggested the need to introduce additional multi-sectorial elements in the ETD to further support energy efficiency and decarbonisation goals.

According to the European Biodiesel Board (EBB), incentives for using all sustainable biofuels, such as crop-based biodiesel, biodiesel from wastes and residues, and advanced biodiesel, should be taken into consideration for tax purposes.

Business Europe stated that an energy taxation update would improve the functioning of the internal market and provide businesses with more tax certainty when making decisions to modernise their production processes. It considered it essential that the ETD not tax those greenhouse emissions that are already subject to the ETS carbon price. They welcomed the Council's recognition that the assessment should consider sectors most exposed to international competition, such as some energy intensive industries where energy costs can reach up to 20 % of total production costs.

After the Commission proposal was published, there was a feedback period from 15 July 2021 until 18 November 2021. There were 202 instances of feedback received: 33 % from Belgium, 16 % from Germany, and 6 % each from Spain, Italy, France and Sweden. Feedback from business associations represented 52 %, companies and business organisations, 35 %. In general, the feedback supported the need to update and align the ETD with the climate challenges.

Academic views

In September 2021, the OECD recommended eliminating those tax exemptions and reductions that subsidise fossil fuel use or other environmentally harmful subsidies. According to an article published in the *International Tax Review*, the taxation of end products is not an absolute principle under the ETD. There are some exemptions however under different terms for energy products and electricity. Therefore, the application of the ETD can lead to situations of double taxation of inputs and outputs.

Legislative process

In the European Parliament, the file is being examined by the Economic and Monetary Affairs committee (ECON) with Johan Van Overtveldt (ECR, Belgium) as rapporteur. The Committee on Industry, Research and Energy (ITRE) is associated committee under Rule 57 of the Rules of Procedure, and has appointed Robert Hajšel as its rapporteur.

In the Council, examination of the proposal has started in the Working Party on Tax Questions. The French Presidency will continue examination of the proposal.

The ETD is based on Article 113 TFEU and is therefore covered by a special legislative procedure.[14]

EUROPEAN PARLIAMENT SUPPORTING ANALYSIS

Hahnkamper-Vandenbulcke N., Review of the Energy Taxation Directive, EPRS, European Parliament, May 2021.

Wilson A., Revision of the Renewable Energy Directive: Fit for 55 package, EPRS, European Parliament, November 2021

OTHER SOURCES

Energy Taxation Directive, Recast, 'Fit for 55 package', Legislative Observatory (OEIL), European Parliament.

ENDNOTES

[1] Article 113 of the Treaty on the Functioning of the European Union (TFEU) aims to harmonise indirect taxes, including excise duties, to ensure the establishment and functioning of the internal market and avoid distorting competition.

[2] The 55 % GHG target was also agreed by Council and Parliament in their interinstitutional negotiations in July 2021 on the European Climate Law.

[3] The Commission must periodically examine the exemptions and reductions and the minimum levels of taxation.

[4] Household tax rates: the ETD allows Member States to exempt the use of energy products and electricity used by households. Heating fuels: the ETD allows Member States to restrict the scope of 'business-use'. Some Member States apply higher non-business rates to certain commercial uses, such as services.

[5] The minimum levels of taxation on motor fuels do not consider the differing energy content or environmental cost of these fuels.

[6] According to international provisions.

[7] Qualified majority voting in Council and the European Parliament on an equal footing.

[8] Fossil fuels benefit from more favourable tax treatment.

[9] Mainly for motor fuels that can be easily and legally transported across borders.

[10] The majority of the respondents were from Germany (27 %), Belgium (20 %), Sweden (11 %), France (8 %), Spain (6 %) and Poland (5 %).

[11] Resulting, in some instances, in de facto fossil fuel subsidies.

[12] A crucial measure considering the role of these sectors in energy consumption and pollution. The minimum tax rates for these fuels will gradually increase over a period of 10 years, while sustainable fuels will benefit from a minimum rate of zero to foster their uptake by these sectors.

[13] This section aims to provide a flavour of the debate and is not intended to be an exhaustive account of all different views on the proposal. Additional information can be found in related publications listed under 'European Parliament supporting analysis'.

[14] Council acting unanimously after consulting the European Parliament and the EESC.

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