ERCST

European Roundtable on Climate Change and Sustainable Transition

2020

Feedback on the

Inception Impact Assessment

Revision of Directive 2003/96/EC (Energy Taxation Directive)

A. Problem the initiative aims to tackle.

The focus of the Inception Impact Assessment (IIA) is the revision of the Energy Taxation Directive 2003/96 (ETD or Directive), which outlines the EU rules for the taxation of electricity and energy products used as heating or motor fuels. A revision is foreseen in the context of the European Green Deal (EGD), an encompassing policy package aiming at transforming the EU into a competitive and resource-efficient economy where greenhouse gas emissions (GHG) reach net-zero by 2050.

Changes are deemed to be required as the policy environment has changed considerably since 2003, the year the Directive was adopted. Internationally the EU has signed the Paris Agreement and has committed to a higher climate ambition both internally through the introduction of new binding targets in the area of energy and climate change. The objectives of the revision that should be considered when examining the ETD include:

- Aligning ETD with EU domestic and international energy and climate policy objectives
- Encouraging use of low carbon products
- Enhancing the common energy market in the EU

<u>Governance</u>

This would not be the first time that a revision is proposed: indeed, in 2011 the Commission presented a revision of the ETD with a view to change the scope and structure of the Directive. Although it was approved by the European Parliament and the European Economic and Social Committee, it encountered political difficulties in the negotiations between Member States (MS) and the proposal was eventually withdrawn in 2015.

One important element that will need to be closely examined is the legal basis that is proposed, and consequently the treaty provisions that are being used.

The ETD is based on is Article 113 of the Treaty of the functioning of the European Union (TFEU), establishing that "*The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and* *other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition*.”.

The current revision aims at overcoming the political issues that resulted in the 2011 proposal being withdrawn by using Article 192 of the TFEU, which allows for the use of Qualified Majority Voting instead of unanimity when voting on **environmental measures including those of fiscal nature**.

In the IIA, the use of Article 192 instead of Article 113 is justified on the basis that the review should focus mostly on environmental issues since it is in line with the EGD. However, there is no guarantee that this suggestion will be taken in by MS, since taxation is a national prerogative, and it is in fact likely that it will be met with strong opposition. To ensure that the proposal passes, assessing the feasibility of using Article 192 instead of Article 113 must necessarily be critically explored in further consultations with MS and in the impact assessment that is being prepared to support the revision. Overcoming this issue is essential to avoid a 2011-2015 situation.

One important part of the assessment should be the implications on the Treaty that such interpretation may have, given that the EGD could be deemed to encompass practically all provisions of the Treaty and may create a precedent.

B. Policy options

The IIA outlines two objectives for the revision of the ETD:

1. To align taxation of energy products and electricity with EU energy and climate policies to achieve the 2030 and 2050 targets in the context of the EGD.
2. To preserve the internal market by updating the scope and structure of rates and by streamlining the use of tax exemptions and reductions by MS.

While the IIA outlines a few policy options, it is encouraging to see that it does not preclude the possibility of alternative approaches that may emerge. This is an approach that should also be adopted in the IIA for CBAM.

This IIA proposes building blocks, on which policy options will be based, are outlined:

- **The minimum excise rates**: while the 2003 Directive only considered volume of energy as the indicator for taxing a certain product, the IIAs states that the review "will take into account various aspects impacting excise rates", such as inflation, energy content and a link to GHG emissions, with the goal to align minimum tax rates to the 2030 and 2050 climate and energy targets.
- **Formula**: A question is how these elements will be incorporated to reach a taxation formula. One option is to consider in the examination incorporating two components into the taxation rate, one which reflects the energy content of the product, and one which accounts for its CO2 emissions. Both are necessary in order to ensure that products with a low carbon content are favoured to those that are more carbon intensive, and to promote energy saving and energy efficiency also through investments in innovative technologies.
- **Sectoral tax differentiation**: the possibility to apply exemptions, differentiated rates and reductions is an approach that IIA proposes, and should be examined. The ETD is part of a wider policy package update prompted by the EGD, and the Commission should seize the opportunity to ensure consistency and coherence in the update of the EGD-related policies, while eliminating any overlap to ensure that future revisions will not have to address issues of inconsistencies.
- **Product coverage**: The IIA commits to analysing how to reconcile the energy and climate objectives with the objective of creating an incentive for low carbon products and which may also generate tax revenue. These provisions will also need to be examined for economic and competitive impacts and for impacts on energy poverty. The inclusion of sectors which have enjoyed optional tax exemptions will need to also be examined as circumstances have changed.

In examining policy options there are a number of issues that would need to be highlighted for consideration

- ETD is an important policy tool and in making significant changes the overlap with, and impact on other important policy instruments, such as the EU ETS, needs to be examined. This will include the review of the MSR and its parameters in order to ensure that the impact of the ETG is factored in, and that the MSR remains an effective instrument to avoid policy overlaps. Given that the ETD could lead to lower demand for EUAs, it may have serious impact on the functioning of the EU ETS, and efficacity of the MSR.

- Examine the interaction of the ETD interact with existing (and new) carbon taxes in EU Member States.
- Consider the issue of double taxation which may arise in some cases where ETS and ETD may overlap.
- Consider the positive effect that the introduction of GHG-based taxation has towards the incentive for the use of lower carbon alternatives.
- While it is true that the components and the formula of the ETG will be the subject of intensive debate, but it is likely that both components (energy and climate) will be incorporated in some manner. Consider the fact that the revenues from taxation cannot be earmarked as this is a matter of Member State sovereignty. In this context the CO_2 component is probably going to general revenue. In contrast, the revenues from ETS auctioning can be earmarked for items associated with the European Green Deal, such as different funds, just transition, etc

C. Preliminary Assessment of Expected Impacts

Given the nature of the matters addressed in this Directive, the most likely impacts will be economic and social. Given the current realities, the IIA will need to put this examination in the context of the post-pandemic economic conditions.

Taxes on energy products and electricity can be regressive, imposing a higher burden on poorer households which spend a higher share of their income on these products. Ultimately, the macroeconomic and social impact of a revision of the ETD will depend on how the revenues generated will be used. If these are recycled through reductions in labour costs, the effects on GDP and employment will be positive. This result is also backed by an impact assessment that accompanied the 2011 revision proposal. Although in theory this result holds, in reality it is often the case that revenues generated from specific taxes are not automatically earmarked into a corresponding revenue recycling channel.

Therefore, it is essential that this positive result does not remain theoretical, but instead is encouraged through provisions in a communication accompanying the revision of the ETD that account for a specific use of revenues. Ultimately, though, choosing how to spend tax revenue is a national prerogative, but the ETD should be revenue neutral in principle.

Additionally, the IIA mentions the Green Deal Investment Plan and the Just Transition Mechanism as tools contributing to addressing energy poverty and the transition needs for investments. It is particularly important that a revision of the ETD examines how it can contribute to the just transition, domestically and internationally.

In addition, examination of the recycling of revenues should also include use to support the development of climate-friendly technologies, R&D for low-carbon technologies, and to improve energy efficiency. Recycling through these channels would also support EU businesses in remaining competitive while decarbonising. Finally, revenues could be used to protect sectors exposed to carbon leakage and in this context, there is a need to examine how this would interact with the discussions on the IIA for CBAM.

Finally, it is inevitable that the use of revenues will be calibrated by taking into account the socio-economic impact of the virus in the EU and globally, and the competition for resource allocation towards economic recovery as well as health care priorities.

D. Evidence base

We welcome the proposal of basing the impact assessment in support of the revision of the ETD on several elements such as:

- Considering the impacts of different tax rates,
- Appropriately addressing the challenge of dealing with CO2 intensity taxation of electricity vs other energy carriers
- How it promotes a market for low carbon products
- How to effectively foster the competitiveness of European industries,
- How to how to encourage investments into new technologies and alternative fuels, and
- Assessing the macro- and microeconomic impacts on society as a whole and on households.

Although we understand that imposing measures to reduce the impact of increased energy taxation on households, such as mandating revenue recycling through reductions in labour taxes, are not a competence of DG TAXUD but rather of MS, we would like to stress the importance of examining of ways and means to provide support for vulnerable communities during the transition towards a sustainable and climate-neutral EU economy.

To ensure this, it's important that these communities are actively consulted together with other key stakeholders, and we strongly encourage the revision of the ETD proposal to be accompanied by a Communication to MS on how to best reduce potential negative impacts on households while promoting energy efficiency and use of sustainable energy.