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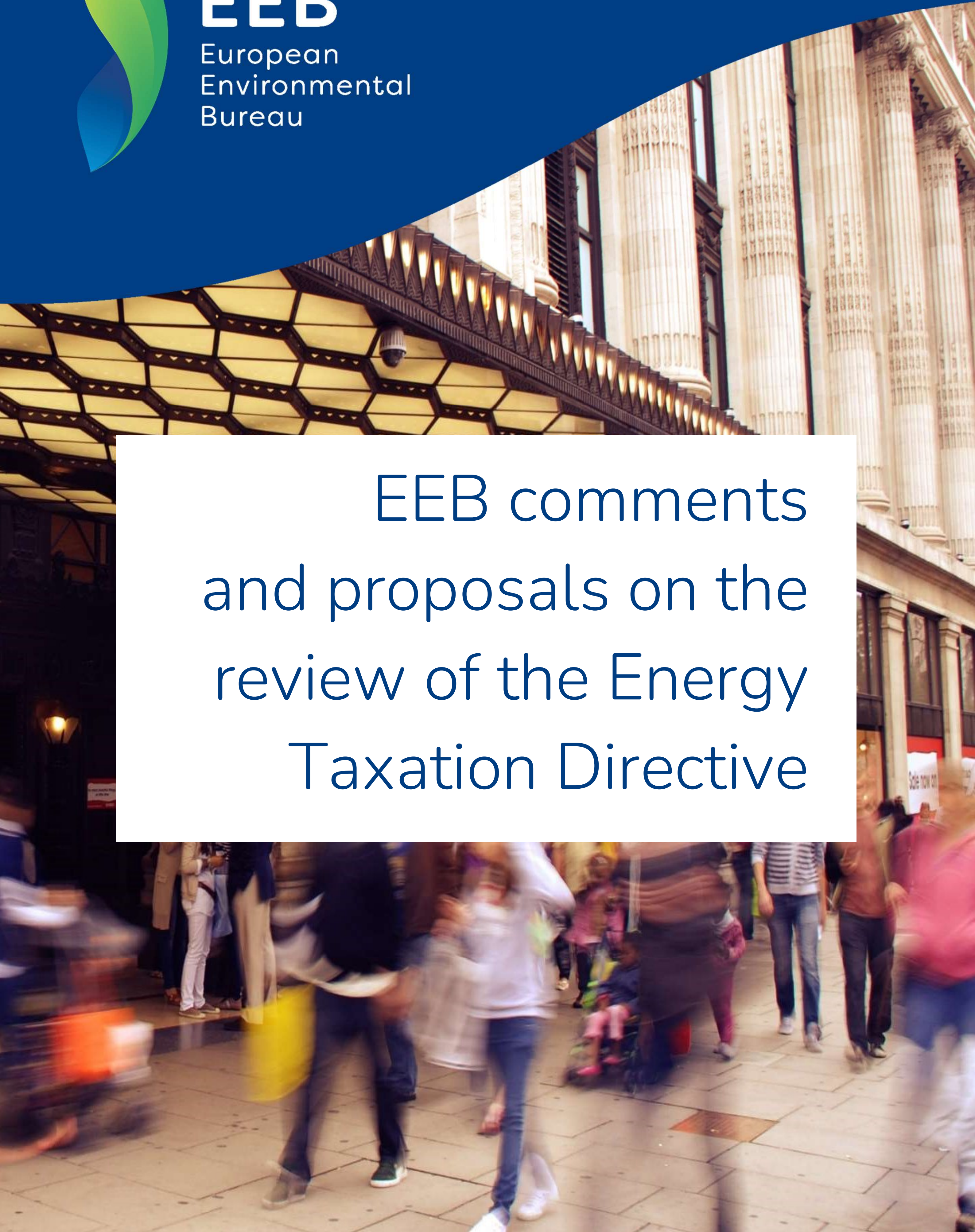

EEB comments and proposals on the review of the Energy Taxation Directive

EEB's comments and preliminary proposals on the review of the Energy Taxation Directive

31st March 2022

Setting the scene

The Energy Taxation Directive (ETD) review will determine how and to what extent energy taxation will contribute to the greening and decarbonisation of our economy.

Taxation must be aligned with the climate objectives of the European Green Deal (EGD) and the Polluter Pays Principle. However, current tax levels do not reflect the extent to which different energy sources pollute and contribute to global warming.

Overall, subsidies for fossil fuels amount to more than €55 billion per year and 15 EU member states spend more on fossil-fuel subsidies than on renewable energy subsidies, a figure which does not take into account the financial support given to poor households during the ongoing gas crisis[1].

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 exemptions and reduced rates. It introduces a new structure of tax rates based on the energy content and, to some extent, to environmental performance of the fuels and electricity while broadening the taxable base by including more products in the scope.

[1] European Court of Auditor report, Review 01/2022: Energy taxation, carbon pricing and energy subsidies, https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=60760

The main changes are the following:

1. Fuels will start being taxed according to their energy content and environmental performance rather than according to their volume.
2. 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.
3. 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.
4. New energy products are recognised, such as hydrogen.
5. It is up to Member States to decide on the use of tax revenues and they can further ensure fairness by using those revenues to mitigate the social impact.
6. Certain reduced rates will remain possible, such as those for electricity or advanced energy products produced from renewables.
7. Several national exemptions and tax reductions will be removed allowing Member States a reduced margin to set rates below the minimum rate for specific sectors.

Our general comments

As it stands, the ETD review is not enough coordinated with other files of the Fit for 55 package and does not fully contribute to EGD goals (such as the Zero Pollution one). We believe that the review of the ETD should be part of a wider and coordinated process of reform to be undertaken by EU Member States' taxation systems, geared towards achieving climate and environmental protection objectives. Only with a comprehensive "green tax reform" will it be possible to pursue the following desirable objectives:

- **Coherence with EU 2030 targets and climate neutrality by 2050 in the context of the European Green Deal.** Establish appropriate and stable price signals to guide energy related investments by businesses and households towards the ecological transition.
- **Equity.** End current distortions in favour of fossil fuels without leading to disruptive social conflicts by compensating those who are hurt by climate policies:
  - implement the necessary measures (in-bill discount, lump-sum payments and income tax reductions) to support the most vulnerable segments of the population,
  - protect the middle classes from the volatility of energy prices,
  - support businesses in the conversion of production and put in place reskilling and retraining programmes for laid-off workers.
- **Revenues and budgetary impacts.** Ensure a stable base of revenues to achieve the decarbonization of energy: due to a widened product coverage, increased minimum rates and the enlargement of taxable base, revenues generated from energy taxation are expected to increase significantly.

We therefore support the long-overdue review of the Energy Taxation Directive **as the starting point** for those Member States that have not yet implemented, or have only started to implement, a full green tax reform to take effective action quickly.

However, there are still some key aspects that need to be addressed by the current regulatory revision.

Our proposals

Rates

The top minimum rates are barely increased compared to today – meaning revenues based on these rates would still fall far short of the external health and ecological costs of burning the fuels.

The minimum rates need to factor in the air pollution component. Though the mechanism that shifts taxation from volumes to energy content provides a better redistribution of the taxation burden, **the categorization does not take into account the very relevant costs for air pollution generated by burning coal and biomass**; benefits of reduced air pollution should be better recognised and balanced against negative distributional effects.

The minimum rates **also need to factor in the carbon content**, *inter alia*, with a mechanism linked to the ETS price (for example, through **a top-up tax**[2]). If the proposal to extend the ETS to buildings and transport (ETS2) fails to be approved during the current inter-institutional negotiations, carbon intensity of energy carriers should be reflected in the rates of ETD. Besides, this would ensure that carbon intensity would also apply to non-ETS sectors such as agriculture.

The volatility of energy prices slows down the rate of investment and favours waiting. It in fact increases the rate of return needed to make an investment in energy efficiency (or in renewable energy production) attractive, with the result that businesses and consumers may prefer to postpone their investment decision. **A top-up tax** that keeps the price of energy products high but constant over time, absorbing the volatility of energy prices, **would allow the determination of a reliable net present value of investments in clean technologies**, helping to accelerate the decarbonisation of the economy.

Sectorial criteria for low/minimum rates application

We believe a mechanism of **threshold** should apply (i.e. guaranteeing lower taxation for a small amount of fuels for tractors to cover small scale farming) with a combined approach based on existing quality premium certifications: certified forest only, organic farming could be examples to combine with thresholds.

Due to the impact that combustion-based energy sources have on health and the environment and considering the benefits of reduced air pollution balancing the negative distributional effects, **the transitional period applicable for some energy products should be much shorter** than the envisaged 10 years.

[2] An example could be a formula that would add x to the excise, where x = f(100-ETS) is updated on a regular base and 100 €/tCO_2 could be the desired level of the carbon price.

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Reduced rates to preserve the competitiveness of energy intensive industries should not apply **if free allowances and state aid for ETS indirect costs remain** in place under the EU ETS

In any case, reduced and minimum **rates should only apply to industries that have approved climate and environmental plans** that are in line with the objectives of the EGD and the climate law.

Tax exemptions for alternative aviation fuels would lead to inefficient uses of resources. **The taxation of all aviation fuels,** on the other hand, would encourage the switch to less energy-intensive forms of transport.

Regarding **cargo-only flights**, we believe tax exemptions should be warranted only in special cases (for example, for essential goods such **as medical supplies in case of emergencies or crises**) that should be listed in the directive. On the contrary, any regular operation should be heavily taxed to discourage the adoption of unsustainable practices.

Social support must be carefully targeted, and energy **prices must reflect the real cost of energy.** Low rates should apply to selected target consumers (energy poor, SME) for a limited amount of time and only upon conditions **these target users are included in the list of beneficiaries of support for upgrading their energy supply (i.e cars, heating).**

Member States should **use tax revenues for specific objectives** and consistently to the EDG, for example to co-finance schemes for the energy renovation of homes, to replace gas boilers with heat pumps and solar thermal or to encourage the construction of new renewable energy plants. Specific guidelines on how to apply energy tax revenues should be provided by the Commission.

If the proposal to extend the ETS to buildings and transport (ETS2) fails to be approved during the current inter-institutional negotiations, the top-up tax, or a relevant part of the energy products taxation revenues **should be used to match European funds in the Climate Social Fund.** This would allow those in conditions of energy and mobility poverty to overcome financial barriers to access cheap energy. For example, by supporting the spread of Renewable Energy Communities, by financing projects for a deep restructuring of social housing assets, by establishing revolving funds for energy efficiency interventions.

The definition of renewable fuels of non-biological origin should be amended to **ensure that low-carbon hydrogen is produced with additional renewable electricity** (avoiding subtracting it from more direct and therefore more efficient uses) and in a genuinely low-carbon way, taking into account all the emissions associated with it, from cradle-to-grave.

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Relevant documents from EEB related to ETD:

- Our blueprint on carbon pricing in Europe.
- Our views on Peter Liese's draft report on ETS.
- Our report on the decarbonisation of heating, highlighting the countries where payback for Heat Pumps is impossible due to unfair taxation/lack of support.
- Our manifesto on the future of heating.

Please refer to davide.sabbadin@eeb.org for comments on this document.

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A better future where people and nature thrive together