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

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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 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.

The main changes are the following:

- Fuels will start being taxed according to their energy content and environmental performance rather than according to their volume
- 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.
- New energy products are recognised, such as hydrogen

[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

- 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
- Certain reduced rates will remain possible, such as those for electricity or advanced energy products produced from renewables.
- 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.

Our preliminary comments

As it stands, the ETD review is not enough coordinated with other files of the Fit for55 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:

- **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 householders 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 (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:

Rates

The minimum rates need to factor in the air pollution component; benefits of reduced air pollution should be better recognised and balanced against negative distributional effects[2]: 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 also to factor in the carbon content, inter alia, with a mechanism linked to the ETS price (for example, through a top-up tax)[3]. 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.

- Though the mechanism that shifts taxation from volumes to energy content provides a better redistribution of the taxation burden, the categorization of the fuels remains a political decision upon the Member States and does not align with what was suggested in the option 2c. notably the very relevant costs for air pollution are not taken into account for coal and biomass.

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

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3 An example could be a formula that would add x to the excise, where (x= 100-ETS II) updated on a regular base.

- 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
- 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 energy upgrades (i.e. heating, transport, renewable technologies upgrades)
- Member States should use tax revenues for specific objectives and consistently to the EDG, for example to finance schemes for the energy renovation of homes of low-income households, to replace gas boilers with heat pumps or to encourage the construction of new renewable energy plants. Specific and binding guidelines on how to recycle energy tax revenues should be provided by the Commission

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