



European Commission proposes a new CO₂ tax and an amended energy tax

The European Commission intends to introduce a tax on carbon dioxide (CO₂) emissions with effect from 2013. The CO₂ tax is intended to complement the existing European emission trading scheme for installations from the power and industry sector. CO₂ tax credits are proposed to be in place until 2020 to avoid carbon leakage. Apart from this, there will be limited exceptions to the CO₂ tax. Energy tax reforms are also proposed, whereby energy is to be taxed according to its energy content. Energy products used for the same purpose will have a uniform energy tax. No distinction will be made between energy used for business and non-business purposes. If it comes into force, the proposal will dramatically change the way energy is taxed in the EU.

Overview

The Energy Taxation Directive 2003/96/EC (ETD) of 27 October 2003 requires member states to tax energy products by volume or according to their energy content. The European Commission (the Commission) published on 13 April 2011 a proposal to amend the ETD (the Proposal). The key amendments were to introduce a tax on carbon dioxide (CO₂) emissions and to reform the energy tax system to tax energy based on the energy content of the energy products. The Proposal includes substantial changes to the draft proposal issued by the Commission in March 2009 (the Draft Proposal).

CO₂ tax for fossil energy products

To date, the European Union's (EU) main instrument for dealing with CO₂ emissions has been the European emission trading scheme (ETS). According to the Commission, the new CO₂ tax will complement the ETS. The CO₂ tax is planned to be introduced with effect from 2013. The new CO₂ tax will apply to all uses not covered by the ETS.

Relationship with emission trading

The ETS is seen as the cornerstone of the EU's strategy for fighting climate change. It is a 'cap and trade' system, ie it caps the level of emissions but, within that limit, allows participants in the system to buy and sell allowances as they require. The ETS is, therefore, a market-based instrument, whereby the market dictates the price of the allowances. The ETS covers certain large facilities, such as

combustion plants with over 20 MW heating power, and certain key industrial areas. Other parts of the economy are not covered by the ETS, such as transport, private households and small businesses as well as agriculture.

The proposed CO₂ tax is less flexible. The minimum rates are set out in the Proposal and cannot be dictated by supply and demand in the market. The Commission, however, has indicated that the CO₂ tax rates might be adapted in the event of a divergence between the market price of the ETS allowances and the CO₂ tax rates. However, the Commission is not obliged to adapt the minimum CO₂ tax rate. Such a flexible approach would decrease the likelihood of unequal treatment concerning the price for CO₂ emissions of different parts of the economy. On the other hand, it reduces the predictability of the amount of CO₂ tax that will need to be paid for a given facility or activity.

The Commission intends to avoid overlaps between the new CO₂ tax and the ETS, and to avoid taxation serving the same purpose. The CO₂ tax will apply to all uses – including for purposes other than heating – of energy products causing CO₂ emissions in installations subject to the ETS. The Proposal, however, provides a mandatory tax exemption for energy products used in activities already subject to the ETS. The relevant wording is as follows:

'Member States shall exempt the following from taxation ... (d) as regards CO₂-related taxation, energy products used for activities subject to, and not excluded from, the

Community scheme within the meaning of Directive 2003/87/EC.’

The Commission’s intention not to double the burden for any given use (by subjecting it to the ETS and the CO₂ tax) is no doubt correct. The crucial question is how this exclusivity will operate in practice. It is questionable whether the system is sufficient to meet the needs of the European industry. The proposal increases the burden for businesses emitting CO₂. Facility operators would have to prove in each case that the conditions for the tax exemption have been met and, as such, the changes would still be likely to give rise to additional administrative overheads and subsequent costs. In addition, leaving it up to the member states to define the rules will most probably lead to different systems throughout the EU.

CO₂ tax credits

One key issue not addressed in the Draft Proposal is that the Commission has proposed a system of CO₂ tax credits. The credits will be available for installations within sectors that are deemed to be exposed to a significant risk of carbon leakage (article 14a of the Proposal). That might also include the agricultural sector. The CO₂ tax credits system will be similar to the free allocation of emission allowances under the ETS.

The CO₂ tax credits are calculated by reference to the median annual consumption of energy products of the installation, excluding energy consumption of motor fuels, over a specified reference period. The Proposal discusses a ‘fuel benchmark’ to adhere to when calculating CO₂ tax credits. The fuel benchmark amounts to 0.00561 and thus corresponds to the figure currently being discussed in the framework of the next allocation period of the ETS. The tax credit system is a transitional measure and will only be in place until 2020. ETS facilities benefiting from the carbon leakage exceptions of the ETS, in contrast, had a longer time to adapt to the new system.

Lack of clarity in the calculation of emissions

As in the Draft Proposal, the Proposal states that the CO₂ tax will be calculated with reference to the CO₂ emission factors contained in Directive 2007/589/EC (Greenhouse Gas Emission Directive). The Proposal outlines that where an emission factor for a particular product is not listed in the Greenhouse Gas Emission Directive, then

‘relevant available information’ should be referred to. It is difficult to determine what the Commission envisaged by relevant available information. Furthermore, if the emission factor of a particular product is unknown, each member state is obliged to determine the emission factor based on the ‘relevant available information’. In practice, this is likely to lead to different interpretations of the emission factor in different member states.

Biofuels

Products that are biofuels are not subject to the CO₂ tax, provided that they meet certain sustainability criteria. Biofuels that do not meet sustainability criteria would be taxed on the basis of the CO₂ emission factor of the equivalent motor or heating fuel.

Minimum CO₂ tax rates

From 1 January 2013, the Proposal introduces a uniform tax rate of 20 €/t CO₂ for both motor fuel and heating fuel. The level of taxation is proportional to the level of CO₂ emissions. Owing to its comparatively high emissions, coal would have one of the highest minimum CO₂ tax rates. Similarly, diesel would be taxed at a higher rate than petrol.

The Draft Proposal had applied higher rates of tax on motor fuels (the equivalent of 30 €/t CO₂) and lower rates of tax on heating fuels (the equivalent of 10 €/t CO₂) than the Proposal.

Amending the energy tax system

There are limited exceptions available to the CO₂ tax. The most important is the system of CO₂ tax credits discussed above. Member states may, in addition, apply CO₂ tax exemptions to households’ and charities’ non-business use of heating fuels and an exemption to coal gas. CO₂ tax exemptions to natural gas and liquefied petroleum gas (LPG) are intended to be phased out by 2023. Most other exceptions available for the current energy tax, such as the mandatory exemption for energy products used in the generation of electricity, will not apply to the CO₂ tax.

Reforming of the energy tax system

The Proposal also introduces a reform to the current energy tax system.

Determining the energy tax

Currently, energy tax is determined by the volume of the energy product, except for natural gas and coal, which are determined by energy content. In future, the energy tax on all energy products will be uniformly determined by energy content.

The energy tax will be calculated on the net calorific value of the energy products and electricity as set out in Directive 2006/32/EC (Energy End-use Efficiency Directive). Where the Energy End-use Efficiency Directive does not contain a reference value to the applicable energy product concerned, member states shall refer to the relevant available information on its net calorific value. This raises the same issues as discussed above in relation to the CO₂ tax.

Alignment every three years

The Proposal also states that the minimum rates of energy tax should be aligned at regular intervals. It is proposed that every three years from 2016 the minimum rates of energy tax should be adapted to take into account changes in the consumer price index. The changes will be based on the EU-wide index of consumer prices, excluding energy and unprocessed foods, to reflect changes in inflation. Member states will be obliged to adopt these changes automatically.

Higher energy tax for motor fuels

The Commission is also proposing that – in the alleged interests of fiscal neutrality – the same minimum levels of taxation should apply to all energy products put to a given use. The main difference applies to heating fuel and motor fuel.

Heating fuel will be taxed at much lower rates than motor fuel. The minimum tax levels for heating fuel will be a uniform 0.15 €/GJ from 1 January 2013.

Motor fuels, on the other hand, will be taxed from 1 January 2018 at a uniform rate of 9.6 €/GJ. Until 2018, transitional tax rates for energy tax on motor fuels are to be introduced. For example, the minimum rate for diesel will be 8.2 €/GJ from 2013 to 2015 and 8.8 €/GJ from 2015 to 2018. The rationale for the transitional rates is to have regard to the important differences in the tax rates currently applied to different motor fuels in several member states. See the table on pages 4 and 5.

Certain uses of motor fuels, however, will be taxed at much lower levels. These include agricultural, horticultural, piscicultural and forestry works, stationary motors, plant and machinery used in construction, civil engineering and public works and vehicles intended for off highway use.

The Draft Proposal had proposed that the minimum level energy tax for motor fuels by 2023 would be between 1 €/GJ for natural gas and LPG and 8.9 €/GJ for petrol, kerosene and diesel. This proposal has been abandoned. As noted above, it is now proposed that minimum rates of energy tax are a uniform 9.6 €/GJ for all energy products used for motor fuel. This results in a considerable energy tax increase on natural gas and LPG.

Business and non-business uses

At present, the minimum energy tax rate applied to heating and electricity is distinguished on the basis of business and non-business use. The Draft Proposal had also intended to distinguish between the business and non-business use of heating and electricity, but this has been abolished in the Proposal.

In addition, the minimum level of energy tax for certain motor fuel energy products (diesel, kerosene, LPG and natural gas) when used for certain commercial uses has also been aligned to the minimum level of energy tax for those products when used as a heating fuel. The rationale is to create as harmonised a tax system as possible.

Currently, there is no distinction between the tax treatment of business and non-business uses of diesel as a motor fuel. It is proposed to maintain this stance. The Draft Proposal, however, had proposed a distinction between the business and non-business uses of diesel as a motor fuel. The Commission states that this distinction no longer appears compatible with the requirement to improve energy efficiency and the need to address the growing environmental effect of transport.

Treatment at national level

Member states will still be entitled to set national energy tax rates above the European thresholds. In future, however, this discretion will be encroached in a considerable manner. When member states set national levels of taxation, the Proposal sets out an obligation that member states replicate the relationship between the minimum levels of taxation fixed for the various energy

sources. This will, in practice, lead to a higher taxation of products with a higher energy content, such as diesel. Owing to the transitional period in place, this obligation in relation to motor fuels does not come into force until 2018. Before 2018, the energy tax rates of certain energy products may be different. Please see the table on pages 4 and 5 for further details.

For example, a minimum energy tax rate of 9.6 €/GJ has been assigned to all motor fuels by 2018. All member states are obliged to ensure tax rates are no lower than these minimum rates by 2018. Portugal, for example, may decide to increase its energy tax for diesel by 1 € above the minimum rate to a total of 10.6 €/GJ. Therefore, Portugal would be obliged to tax all other motor fuels such as petrol at 10.6 €/GJ.

Spain and France will be authorised to introduce higher rates of energy tax in certain regions. However, the Proposal is clear that competing energy sources still need to be taxed equally. For example, Paris may have different energy tax rates to Lyon, but all motor fuels would still need to be assigned the same tax rates in Paris.

Biofuels

The current legislation distinguishes between whether certain biofuels are energy products or not, based on the biofuel's use. This distinction will partially be abolished; the biofuels biodiesel and ethyl tert-butyl ether (ETBE) will always be considered energy products. This clearly increases the legal certainty surrounding these products. However, it will cause practical problems in cases where the biofuel is not used in an energy-generating manner, eg if biodiesel is sold as a chemical component.

It is proposed that biomass or products made of biomass – as per the current ETD – will be subject to energy tax. The reference values will be those set out in Directive 2009/28/EC (Renewable Energy Sources Directive), provided the biofuel meets certain sustainability criteria.

Currently, member states are entitled to provide for an exemption or tax reduction for biofuels. The Proposal aims to gradually phase out the option for member states to provide for an exemption or tax reduction for biofuels. Member states will have an option to apply an exemption or a reduced rate tax on biofuels up until 2022. However, this exemption will only be available to biofuels that meet certain sustainability criteria.

In contrast, the Draft Proposal had proposed an outright abolition of tax exemptions or reductions for biofuels.

There are other tax advantages against using conventional fuels, based on the lower energy content of biofuels and on the CO₂ tax exemption. However, these will most likely not be enough to compensate for the higher production costs of biofuels. A considerable setback threatens the European renewable energy industry.

Abolition of tax exemption for electricity

Currently, electricity is excluded from the scope of the ETD when it accounts for more than 50 per cent of the cost of a product. It is proposed that this will no longer be the case and electricity will be subject to the EU energy tax system even if it accounts for more than 50 per cent of the cost of the product.

Abolition of tax privileges for agriculture

Energy tax benefits for certain uses are to be cancelled. Until now, member states have been allowed to exempt certain energy products and electricity for agricultural use from the energy tax. According to the Commission, favouring agriculture threatens the coherence of the tax system and should, therefore, be abolished.

Exemptions for vessels

There is currently an exemption to energy tax for electricity that is produced on board a craft, including while at berth in a port. The Proposal intends to extend this exemption to shore-side electricity provided to ships while at berth in a port. This mandatory exemption will only be available until 2020 and is intended to encourage development of this cleaner alternative technology.

Minimum CO₂ and energy tax rates for motor fuel¹

Tax	CO ₂	Energy	Energy	Energy
Implementation	1 Jan 2013	1 Jan 2013	1 Jan 2015	1 Jan 2018
Petrol	20 €/t	9.6 €/GJ	9.6 €/GJ	9.6 €/GJ
Diesel	20 €/t	8.2 €/GJ	8.8 €/GJ	9.6 €/GJ
Kerosene	20 €/t	8.6 €/GJ	9.2 €/GJ	9.6 €/GJ
LPG	20 €/t	1.5 €/GJ	5.5 €/GJ	9.6 €/GJ
Natural gas	20 €/t	1.5 €/GJ	5.5 €/GJ	9.6 €/GJ

¹ This table does not include the lower taxes given to motor fuels used for certain uses.

Minimum CO₂ and energy tax rates for heating fuel

Tax	CO ₂	Energy
Implementation	1 Jan 2013	1 Jan 2013
Diesel	20 €/t	0.15 €/GJ
Heavy fuel oil	20 €/t	0.15 €/GJ
Kerosene	20 €/t	0.15 €/GJ
LPG	20 €/t	0.15 €/GJ
Natural gas	20 €/t	0.15 €/GJ
Coal and coke	20 €/t	0.15 €/GJ

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