Taxation of energy products and electricity: restructuring the Community framework

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This Commission communication accompanies the proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity (ETD).

The document recalls that energy consumption is responsible for the majority of greenhouse gas emission, representing 79% of total gas emissions. As part of the Europe 2020 strategy, Member States are committed to setting national targets for energy efficiency implying substantial energy savings.Energy taxation as a key driver towards the Europe 2020 goals.

Need to act: according to the Commission, revising the ETD is imperative so as to make it more consistent with other EU policies for several reasons:

Energy policy: the ETD provides no incentive or even price signal to promote alternative energies and encourage consumers to save energy. With taxation based on volume, ethanol is effectively the most heavily taxed energy product today. The same goes for energy sources used for heating, where coal is currently the least taxed energy source.

Environment: sectors outside the EU ETS such as transport, small industrial installations, agriculture and households account for half of the CO2 emissions. Here, a potential lack of coordination between the ETD and the EU ETS may give rise to a double burden or, conversely, to the possibility of evading the responsibility for emissions.

Single market: Member States are beginning to implement a variety of different approaches to environmental taxation, which may lead to distortions and double taxation within the single market.

Revision of the ETD: in this context and in line with the March 2008 European Council?s request, the Commission is presenting its proposal for a revision of Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity "the ETD") to allow Member States to make the best use of an existing instrument in the new policy framework. More rational and targeted energy taxation will contribute in a technology-neutral manner to cleaner and more efficient consumption of energy, therefore supporting sustainable growth. In a nutshell, the proposal for the ETD revision:

- rebalances the charge between different fuels, including renewable energies, in an objective manner (based on energy content and on CO2 emissions);
- provides for a framework for CO2 taxation in the internal market and in that way puts a price on CO2 emissions which are not covered by the EU Emission Trading System.

To this end, the Commission proposes to split the minimum rate of taxation of energy products into two parts:

- CO2-related taxation, based on the CO2 emissions of the energy product, fixed at a level of 20 euro per tonne CO2;
- General energy consumption taxation, based on energy content measured in GJ, regardless of the energy product, thus providing an incentive to save energy. The tax will reflect the actual energy that a product generates and energy efficient consumption would automatically be rewarded. For motor fuels, the minimum level of taxation is fixed at 9.6 euro per Gigajoule, which corresponds to the current minimum rate applicable for petrol minus the corresponding CO2 part of the minima. For heating fuels, the current minimum level for electricity of 0.15 euro per Gigajoule (corresponding to approximately 0.5 euro per MWh) is applied to all the energy products used for heating, taking into account the energy content of the respective product. The scope of energy taxation remains unchanged and comprises heating use and motor fuel use and consumption of electricity in similar situations.

The proposal to revise the ETD removes counter-productive subsidies and inconsistencies that at present exist in energy taxation. It reduces the tax burden on renewable energies and rebalances the charge between different fossil fuels in an objective manner (in basing it on energy content and CO2 emissions). In consequence, sources of energy rich in CO2 or with high energy content will be taxed more per physical volume unit. This will encourage the consumption of energy sources emitting less CO2 and reward more energy efficiency, in line with and supporting EU climate and energy policies.

In relation to competitors outside the EU, in order to avoid that CO2-related taxation makes our companies leave Europe while emissions globally remain unchanged or increase ("carbon leakage"), the proposal introduces an approach similar to the free allocation of allowances under the EU ETS for sectors that are deemed to be at a significant risk of carbon leakage. Small industrial installations subject to the CO2-related taxation will be granted a lump sum tax credit calculated on the basis of a fuel benchmark.

Particular situations will continue to be given appropriate treatment:

- acknowledging that differences in taxation of domestic heating are less relevant for the proper functioning of the internal market and that heating costs might be an important issue in the domestic social conditions of some Member State, the Commission proposes to maintain the possibility for Member States to apply tax exemptions or reductions for energy products and electricity and to extend it to all heating fuels;
- CO2-intensive energy sources (such as coal) will be subject to a higher charge under the revised system. The change will ensure that all energy consumers, not only those included in the EU emission trading system, face an incentive to shift towards cleaner energy sources;
- diesel will gradually face higher minimum levels of taxation per litre compared to petrol as a mere consequence of the fact that diesel has a higher energy content and also generates more CO2 emissions per litre than petrol. The gradual phasing-in of the new tax treatment for diesel will also provide for an adaptation period for the commercial transport sector;
- lower minimum rates apply to motor fuel used in agriculture, aquaculture and horticulture and this will remain the case with the ETD revision. The ETD revision will affect the current possibility for Member States to fully exempt from taxation motor fuels and heating

fuels as well as electricity consumed in these sectors.

The precise impacts of the ETD revision will to a large degree depend on pre-existing national rates and on the choices made by Member States in accordance with the subsidiarity principle, in particular on the balance between the CO2 and the energy component of the tax and the tax rates applied.The impacts of the proposal would also depend on the extent to which Member States decide to avail themselves of the transitional periods and options contained in the proposal.

Advantages: the revision of the ETD as proposed by the Commission will:

- restructure the current energy tax system in order to make it more efficient and consistent;
- improve the functioning of the Internal Market, creating a level playing field for businesses which will be treated on equal footing, whether they consume oil, natural gas, coal or biomass;
- have considerable positive environmental steering effects and thus contribute to realising the objectives of the Europe 2020 strategy;
- help, in the longer run, Member States to implement more ambitious policies on national level - due to both the need to fulfil environmental objectives as well as fiscal needs ? which is why the proposal has the potential to provide efficiency gains that go largely beyond the impacts/gains at the time of the implementation;
- provide legal certainty for their structural reforms of their fiscal policies and tax systems under way in the exit from the economic and financial crisis.