ACCOUNTANCY EUROPE.

Commissioner Gentiloni
DG TAXUD
European Commission

14 October 2020

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Subject: Consultation on the revision to the Energy Tax Directive 2003/96

Dear Commissioner Gentiloni,

Please find attached our views on the Energy Tax Directive (ETD) and the potential revisions thereto.

At the time of its adoption, the ETD represented a positive contribution to the EU legislative framework by establishing harmonised common rules at the EU level for the taxation of energy products used as motor and heating fuel, and of electricity. Technologies, energy markets and the EU / domestic legislative framework have evolved over the past 15 years and there is now a significant misalignment between the ETD and the expanded policy expectations that stakeholders have for it.

A CO-ORDINATED AND COHERENT APPROACH

We would welcome a holistic and coherent policy approach for the implementation of taxation measures on pollution and resources consumption in Europe, covering domestic and business energy usage. The topic is complex – how to modernize the EU's energy policy to be more sustainable without making the poorest poorer, further damaging key industries already hurt by the Coronavirus crisis and without creating long-term damage to the competitiveness of the EU.

Thus, the revision of the ETD should be coordinated with other connected policies foreseen by the European Commission and EU Member States to design a competitive EU tax policy system. The revision of the ETD should not be considered independently from other policy tools, such as the carbon border adjustment mechanism and the EU Emission Trading System. In addition, the mechanics of the ETD should be simple (to understand, implement, administer and control) and fair.

A DATA AND SCIENCE LED APPROACH

The revision to the ETD should also be data based - using already existing sources of information (e.g. OECD statistics https://stats.oecd.org/Index.aspx?DataSetCode=AIR_GHG showing CO2 emissions per industry or type of activity) as well as appropriate novel research that could be initiated by the European Commission.

It is also important that tax policy in this area is led by science. Calculating the total externalities of different fuel types from extraction, through to production, distribution, consumption and finally, decommissioning, is very complex but it is entirely necessary to combat misinformation and misconceptions.

For example, battery electric vehicles and hydrogen fuel cell cars are both emissions free at the point of use but are currently rarely carbon neutral overall. This is because much electricity and most hydrogen is produced using processes that generate significant amounts of greenhouse gas (GHG) and local pollution.

In this respect, our answers to the survey are based on the assumption that the alternative fuels or fuel sources (particularly electricity) will be derived from low-carbon or carbon neutral, renewable, processes\energy generation, which in reality, is still far from the case across Europe.

PROTECTING EU CITIZENS, BUSINESSES AND COMPETITIVENESS

Many industries would be impacted by an expansion of the ETD, and other related green tax policy projects, to achieve the required shift of the EU towards a sustainable future. Many of the industries most affected by an increase in energy taxation, for example transport and agriculture, employ large numbers of low-paid workers.

All the consequent social and economic effects would have to be dealt with to achieve public support for the measures and thereby lead to behavioural change. To achieve this, tax on energy and pollution would need to be as neutral as possible, combined with direct public subsidies to deal with social fairness. The funds derived from the revised ETD, as well as from other similar tax policy tools, would provide the means to subsidise citizens and the worst affected economic sectors to ease their transition towards sustainable models.

Pricing the use of energy or pollution would not alone be sufficient to shift the EU towards a sustainable economy. It is also necessary to invest in and stimulate sustainable/low carbon technologies and businesses, both to develop new sustainable business models and to facilitate the sustainable transformation/transition of existing traditional EU industries and businesses.

GREEN TAXES AS AN ELEMENT OF SUSTAINABLE TAX SYSTEMS

One of the underlying questions of the revision of the ETD, especially in the Covid-19 crisis, is the competitiveness of the EU economy (notably to retain business in Europe or the need to relocate business to Europe). Member States within the EU must adapt their tax policies to ensure tax neutrality and encourage companies to invest in Europe. Further tax integration within the EU may ease such a policy change to achieve a sustainable economy.

Before implementing significant changes to tax systems in respect of ‘green taxes’, it is first necessary to clearly establish the prime policy objective of increasing taxes through such means as the ETD. Green taxes could help in fighting global heating\pollution, raise revenue for Member States in highly in debt due to the Coronavirus crisis, or shifting the tax burden from employment to help stimulate employment.

However, green taxes are unlikely to be able to accomplish all these objectives simultaneously.

In our opinion, the primary objective of ‘green taxation’ should be to accelerate the shift towards a carbon neutral economy. This would not provide a source of long-term funding for governments because if ‘green taxes’ are successful in changing behaviour, polluting activities would disappear, taking with them the related tax revenue. Continued long-term revenue from green taxes would, conversely, indicate their failure in achieving what most stakeholders view as their primary objective – carbon neutrality in the EU.

Existing sources of revenue could be in turn be diminished by increased green taxation - for example, vehicle, road and fuel taxes, which generate hundreds of billions of euros in fiscal revenue for governments across Europe, funding their public policies (https://www.acea.be/industry-topics/tag/category/taxation).

This is why 'green taxes' cannot be considered in isolation but rather as an element of a broader redesign of the EU tax system to deal with not only global heating but other 21 Century issues, such as digitisation, pollution, water scarcity, waste, unemployment and underemployment. What is needed is a sustainable tax system that helps deal with the issues mentioned but also provides a resilient tax system that provides funding for public policies, promotes economic growth and results in a competitive and efficient EU.

Please find below our detailed thoughts on certain questions in the public consultation.

4 General context for the revision of Energy Taxation Directive and main challenge

Question 4.2.2 – whilst we agree with the objective for the EU to become carbon neutral, the current climate data would seem to indicate that a target date of 2050 is too late.

Question 4.4.7 - We are aware of significant divergence in application of energy taxation across the EU. One of the best examples is aviation fuel, which is, other than that used in private pleasure-flying, exempt from excise duty in accordance with Energy Tax Directive 2003/96/EC (Article 14(1)(b)). However, Member States can tax aviation fuel for domestic flights and, by means of bilateral agreements, also fuel used in intra-EU flights. In such cases, Member States may apply a level of taxation below the minimum level set out in the Energy Tax Directive.

Consequently, it would be far better to have an aligned, harmonised system, instead of a collection of individual rules with Member States having the opportunity to opt out of the framework.

Question 4.5. and Question 4.6.1– the Coronavirus crisis has indicated the public finance issues that arise from a heavy reliance on employment and consumption taxes and a consequent need to examine the resilience and sustainability of tax systems. It is, however, not a clear-cut issue as energy consumption and pollution have also fallen during the last 6 months, which would have reduced the income from taxes based around energy consumption.

Additionally, we can see some long-term economic benefits from moving some element of the taxation burden from payroll and towards energy and resource use and this has been called for at an international level by various institutions (e.g. the World Bank, OECD, IMF, Eurogroup and EC). However, care must be taken to prioritise the main reason for revising the ETD – objectives of raising long-term income for public finances and at the same time reduce GHG emissions are probably mutuality exclusive.

In our view, the main aim of these taxes should be to help towards carbon neutrality as soon as possible, which may not result in a substantial amount of excess revenue to be applied to other desirable objectives.

Question 4.6.2 – the answer to this question is predicated on the introduction of an **effective** Carbon Border Adjustment Mechanism (CBAM) which covers a substantial proportion of the economy.

Question 4.6.4 and 4.6.7 – for purposes of equity and to assist with public acceptance of the policy, it is necessary to introduce compensation for the poorest members of society, for many of whom energy costs represent a disproportionate amount of their expenditure. However, we are not convinced that the tax system is necessarily the best means for achieving this – direct social benefits are often more effective and also avoid further complicating already labyrinthine tax systems.

Question 4.6.8 and **4.6.9**' – we support the idea of subsidising alternative energy sources but only if the impacts of each is properly considered. For example, the widespread destruction of rainforest for land to produce biofuel would increase carbon emissions (biofuels are sustainable but not carbon neutral) and converting land used for food production to produce biofuels would increase food shortages in some of the world's poorest countries.

Equally, hydrogen is only a clean fuel if produced and transported in a carbon neutral manner and much of current hydrogen production is produced as a side-product of petro-chemical production. Producing hydrogen by electrolysis consumes a lot of energy – which would have to be 'green energy' for hydrogen to qualify as a green fuel.

5 Social impact and compensation measures

We have considered some of these issues in section 4 above.

As mentioned, some sort of recompense for those in 'energy poverty' will be required. Lump sum allowances and tax-free thresholds may help general political acceptance of increased taxation on energy costs but will not incentivise behavioural changes to reduce consumption and are not an efficient use of public money.

Subsidised schemes to assist households in improving their energy efficiency could be beneficial in reducing GHG emissions and reducing energy poverty but need to be properly managed to avoid fraud.

6.1 Minimum Tax Rates

Our preference for the long-term would be for the minimum tax rate to be based on all externalities. However, as this is likely to be complicated, in the short-term basing the tax on the amount of GHG per joule would be a significant improvement over the current ETD.

7 Exceptions specific to some areas of activity

In principle, to achieve meaningful reductions in GHG emissions, there should be no exemptions. Continuing to subside fossil fuel consumption in sectors that are traditionally responsible for high GHG emissions will not lead to a significant change in behaviour or business models.

However, some of the sectors mentioned, such as agriculture, transport and travel employ many people on low incomes who will be disproportionately adversely affected by increased taxes on energy consumption. Additionally, some of these sectors continue to suffer badly from the Coronavirus crisis and are likely to be weak for some time.

Consequently, it will be necessary to look at the phasing in of increased taxes in some sectors, perhaps supported by targeted short-term grants to increase income and promote investment in green technology.

Question 7.2.3 – our answer for this question is predicated on the assumption that electricity is from lower carbon, and eventually, carbon-neutral sources of energy production. If electricity is derived from coal fired stations, for example, evidence exists to suggest that electric vehicles are more polluting then those powered by internal combustion engines.

A lower tax rate for electricity could enhance the uptake of electric vehicles. However, a major limitation in the uptake of electric vehicles is 'range fear'. Consequently, it may also be necessary to introduce tax incentives to promote the construction of charging network and innovations such as in-road charging to help promote the uptake of electric vehicles.

Investment is also essential in clean and efficient public transport, which will help reduce the reliance on private transport.

Question 7.4.4 – the provisions related to the tax exemption for energy products appears, a priori, clear and comprehensive but this is a very complex area. It has led to a significant number of cases at the European Court of Justice.

8. Lower Carbon products and applications

As hydrogen is carbon free whether burnt or used in fuel cells, it has the potential to be both carbon-neutral and pollution free but only if produced using clean energy sources. Much of current production comes as part of the petro-chemical process and is both polluting and carbon intensive.

Producing hydrogen via electrolysis uses a lot of power and is currently more expensive than extracting it from fossil fuels. Consequently, there would need to be an increasing generation of carbon neutral electricity before hydrogen becomes a truly clean fuel source. Alternative means of production are still on the horizon. Additionally, transporting hydrogen requires energy, which needs to be factored into the equation.

There is also the added complication that hydrogen is highly explosive and difficult to store and transport. This is likely to limit its practical usage – whilst it could be used as a heating fuel, for example, safety fears are likely to count against this.

Equally, its use in hydrogen fuel cell motor vehicles is also problematic from both a safety and efficiency point of view. There are already limitations on where LPG vehicles can travel, and hydrogen is potentially more dangerous that LPG. Additionally, hydrogen fuel cells only show a total efficiency rating of around half of that for battery electric vehicles. The one advantage of hydrogen fuelled vehicles over battery electric vehicles is increased range – which may make this a more valuable source of low carbon fuel for the transport and aviation industry rather than for private motorists.

In respect of e-fuels, we assume that this refers to fuels created combining hydrogen (presumable extracted in a carbon neutral manner) with existing CO2 (produced as part of industrial processes) to produce synthetic fuels. Whilst we welcome the research such synthetic fuels, they are still in their infancy and are very expensive.

Additionally, there is an argument that using CO2 from industrial processes gives no incentive to cut CO2 emissions and may even act as an incentive to produce more. There is also an expectation that, in the early stages at least, that the synthetic fuels will be mixed with existing fossil fuels, thereby minimising the potential benefit for reducing CO2 emissions.

That being said, synthetic fuels, if they can be produced in a carbon neutral manner, could play a significant role in the early stages of de-carbonising aviation, where it is difficult to envisage a widespread move towards electric power. At this stage, however, we consider it too early to give these fuels a preferential tax treatment – at least until such time as their green credentials can be proven.

Sincerely,

Florin Toma
President

Olivier Boutellis-Taft
Chief Executive

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