FIT FOR 55 - EU PROPOSES ENERGY TAX OVERHAUL TO MEET CLIMATE TARGETS

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Legal Briefings

We size up proposals to recast the Energy Taxation Directive as Brussels toughen climate change stance.

The Energy Taxation Directive (2003/96/EC) was originally introduced in 2003 and laid down a harmonised structure and minimum excise duty rates for the taxation of certain energy products and electricity, based on their volume. The Commission considers that – in light of the EU's environmental objectives – this approach is no longer fit for purpose. In particular, this is because the current legislation effectively favours the use of fossil fuels rather than encouraging a reduction in greenhouse gas emissions.

KEY CHANGES

The objective of the proposed revision is to support a switch to cleaner energy, more sustainable industry and more environmentally friendly choices. To this effect, the proposal introduces the following main changes to the current framework.

Revision of minimum excise rates for energy products and electricity

The proposal increases and adjusts minimum rates for energy products and electricity. The rates are intended to reflect the energy sources and their environmental impact and are designed to ensure that the most polluting fuels are taxed the highest:

- *Conventional fossil fuels, such as gas oil and petrol, and non-sustainable biofuels*: These are considered to be the most-polluting types of energy and will thus be subject to the highest minimum rate (the so-called "reference rate") of €10.75/GJ when used as a motor fuel and €0.9/GJ when used for heating.

- *Natural gas, LPG, and non-renewable fuels of non-biological origin*: These energy sources are fossil-based and can support decarbonisation in the short and medium term. As such, only two thirds of the reference rate will apply to this category for a transitional period of 10 years, i.e. a minimum rate of €7.17/GJ when used for motor fuel and €0.6/GJ when used for heating. Following this transitional period, they will be taxed at the same rate as conventional fossil fuels, i.e. the full reference rate.

- *Sustainable, but not advanced biofuels*: To reflect these products' potential in supporting decarbonisation, 50% of reference rate applies, i.e. a minimum rate of €5.38/GJ when used as motor fuel and €0.45/GJ when used for heating.

- *Electricity, sustainable biofuels and biogas, and renewable fuels of non-biological origin such as renewable hydrogen*: The lowest minimum rate of €0.15/GJ applies. The rate is set significantly below the reference rate as electricity and the listed fuels are capable of significantly supporting the EU's climate action objectives.

- *Low-carbon hydrogen and other low-carbon fuels*: These energy products will also benefit from the minimum rate of €0.15/GJ for a transitional period of 10 years after which they will be subject to a minimum rate of €5.38/GJ.

Importantly, energy products and electricity used for chemical reduction and in electrolytic and metallurgical processes are excluded from the taxation.

Unlike under the current regime, the above minimum rates are to be adjusted annually by the Commission by way of a delegated act, to reflect changes in the harmonised index of consumer prices excluding energy and unprocessed food as published by Eurostat.

Simultaneously, Member States will be encouraged to support vulnerable consumers and households through this green transition, including by way of lump sum transfers or access to financing for low-carbon and energy efficient goods and appliances. Furthermore, Member States will be able to exempt vulnerable and energy poor households from taxation on the supply of heating fuels and electricity.

Extension of excise rates to additional energy products

The proposal extends the taxation to certain previously exempted products, uses and sectors. This includes, in particular:

- Kerosene used as fuel in the *aviation industry*, specifically for intra-EU passenger flights. The excise duty for aviation fuel will be increased gradually over a transitional period of 10 years, after which the reference rate (i.e. the highest minimum rate and the same that applies to petrol used in road transport) will apply.

- Heavy oil used in the *maritime industry*, specifically in intra-EU ferry, fishing and freight vessels.
- The use of energy for *mineralogical processes*.

The extension of taxation to the previously exempted air and maritime transport (and the fishing sector) is driven by the desire to achieve a more equitable distribution of environmental costs in the transport sector.

Furthermore, to encourage a cleaner energy transition, sustainable and alternative fuels will benefit from a zero rate minimum tax rate for a transitional period of 10 years when used for air and maritime / fishing navigation.

Elimination of Member States exemptions / reductions

The current energy taxation framework leaves significant scope for the introduction of national exemptions / reductions for specific energy products / sectors by individual Member States. The Commission notes that – in practice – this has led to a *de facto* favouring of the use of fossil fuels in the EU (such as various reductions for diesel), while contributing to the fragmentation of the EU’s Single Market (given the different rates applicable to energy use across Member States). As such, the Commission proposes to phase out most of these exemptions, and revise the legislation in a way which leaves much less leeway for Member States to apply taxes which are below the minimum harmonised rates.

COMMENTS

The Commission’s proposed revision of the Energy Taxation Directive, if adopted, will have the effect of significantly redrawing the EU’s energy landscape. It will provide consumers with clear incentives for the use of cleaner sources of energy but will inevitably make some of the more traditional (and polluting) energy sources (such as petrol) more costly. The Commission expects that this will be counterbalanced by Member States adopting national measures to support the most vulnerable households, but what happens in practice remains to be seen.

In terms of legislative procedure – given that the proposal concerns the harmonisation of taxation (more specifically that of excise duties) – it will have to adopted by way of the “special legislative procedure” which requires unanimity in the Council (effectively unanimity among the 27 EU Member States). The European Parliament will have to be consulted but otherwise will play a minor role in this process.

In the Council, some opposition and requests for the softening of the proposal can be expected in particular from Central and Eastern European Member States. This is mainly because of the additional burden the proposal will place on their national economies as well as due to their generally more sceptical views concerning the need to tackle climate change.

The Commission’s proposal envisages the application of the new rules from 1 January 2023. While this is admittedly an ambitious target, given the EU’s emphasis on its Green Deal initiatives, there is a high likelihood that the new legislation will be adopted by then.

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