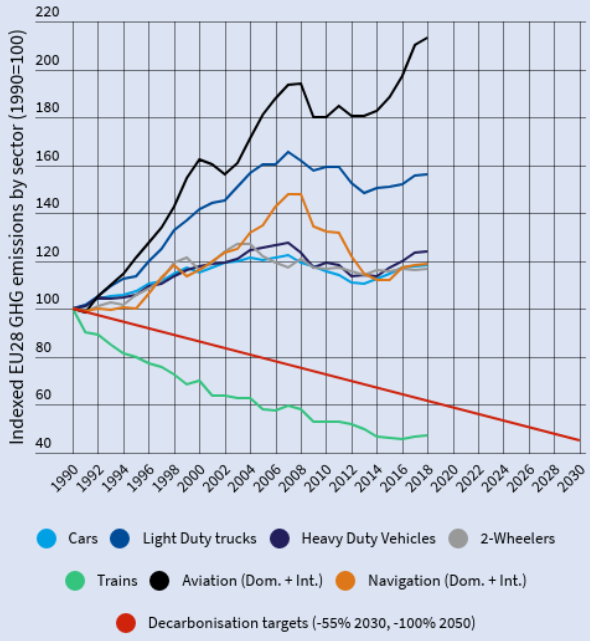
The Energy Taxation Directive

T&E's feedback on the Inception Impact Assessment

March 2020

Summary

While every other sector's climate emissions have decreased since 1990, on average, transport emissions have increased by almost 30% since 1990 (aviation emissions, for one, have more than doubled). Each mode of transport faces varying challenges to reverse this trend and reduce them in the coming decade. If the European Green Deal is to radically reduce the EU's climate impact, it has to radically reshape European transport by using all necessary carbon pricing tools at its disposal, including revising the Energy Taxation Directive.



Data source: Member State reporting to the UNFCCC. 2018 data from EEA proxy GHG emission database.

The Energy Taxation Directive (ETD) has not been reviewed since 2003, and needs updating if the European Commission is serious about deploying its European Green Deal. **A new updated ETD should send the right pricing signals to influence investment towards low emissions energy sources for transport.** This paper is meant to inform policy makers of T&E's views on the main elements to take into account for the next revision of the ETD in 2021.

1. **Legislative process**: The urgency of climate change and the EU's environmental ambitions justify using the ordinary legislative procedure to revise the ETD instead of unanimity, through the use of passerelle clauses. The distortions in competition created by the current taxation treatments of different modes of transport could also justify the use of Article 116 TFUE to revise the ETD and lift unanimity rules.

2. **Sector specific recommendations**
   A. **Aviation: finally ending its fossil fuel tax holiday**

- **Ending the exemption for kerosene fuel taxation** & allow for the introduction of an EU-wide kerosene taxation on intra-EU routes as well as departing from Europe
- **Promoting bilateral kerosene taxation** by issuing guidance to member states on ways to implement bilateral or multilateral taxation agreements for kerosene.
- **Ensuring both the ETD and EU Emissions Trading System (ETS)** apply to aviation, as it is the case for energy and industry sectors.

B. **Shipping: EU ETS more effective carbon pricing than an EU-wide fuel tax**

- **EU wide marine fuel taxation would not be an effective way of implementing** carbon pricing for shipping, because of tankering.
- **Shore Side Electricity supplied to ships** should remain an affordable and economically preferable option through a favorable tax regime under the ETD.
- **Other measures are necessary to drive the uptake of zero-carbon marine fuels**: operational CO2 standards applied to existing fleets, and zero-emission berth standards - both under the scope of the MRV Regulation (EU) 2015/757.

C. **Road transport & promoting zero emission mobility**

- **Reflect CO2 impact of fuels in taxation rates for diesel, petrol & natural gas** by harmonising diesel and petrol taxes as well as establishing effective minimum natural gas tax rates for CNG & LNG use in transport. Remove the possibility for member states to apply total or partial exemptions or reductions in the level of taxation to natural gas and LPG used as transport propellants.
- **Put an end to truck fuel tourism**, by implementing a system like the International Fuel Tax Agreement (IFTA), through the use of the tachograph.
- **Tax biofuels based on their CO2 impact** and end the tax exemption for biomass based fuels.
- **Promote electro-mobility** by giving tax rebates or incentives to zero emission (electric) corporate fleets/company cars.
- **Keep fuel taxes linked to inflation**.

1. Today's climate emergency & tax distortions justifies an urgent revision of energy taxation rules

Europe's climate emergency and distortions created by today's taxation framework, justifies the need to avoid repeating the mistakes of the past. Instead of being withdrawn due to disagreements and unanimity rules in Council, this new revision of the ETD should be shifted to normal legislative procedures.

1.1. Carbon pricing to help deploy the EU Green Deal for transport

The European Green Deal announced an ambitious plan to revamp transport and to set all sectors and modes towards a zero emission path, including through effective carbon pricing and the application of the polluters pay principle. **All this represents an opportunity to put transport on track to achieving zero emissions and years ahead are crucial to help Europe become carbon neutral by 2050.**

The Energy Taxation Directive (ETD) has not been reviewed since 2003, and needs serious updating given the European Commission's new ambitions. **A new updated ETD should send the right economic signals to influence markets and investment decisions towards low emissions energy sources.** This will in turn have three main overarching benefits:

1. **Environmental**: It will stimulate all possible avenues for lower oil use and reduce transport's CO2 emissions. Europe's comparatively high fuel taxes are one of the reasons Europeans use around 60% less transport fuel per head than Americans.
2. **Economical**: a revised framework will help guide industrial innovation towards sustainability as consumers have greater incentives to buy more fuel-efficient vehicles or travel more sustainably.
3. **Social**: the revenue generated by an updated ETD can help member states support the much needed labour transition to sustainable jobs.

1.2. Surmounting political obstacles by lifting the unanimity rule

T&E welcomes the European Commission's ambition to **move to Qualified Voting Majority (QMV) when it comes to energy taxation**. In 2015, the European Commission withdrew its 2011 proposal to revise the ETD given the inability of the unanimity rule to resolve disagreements between member states on taxation. This situation cannot be replicated in 2021, as the climate emergency demands urgent action, the EU cannot afford postponing once again a review of the EU's energy taxation rules.

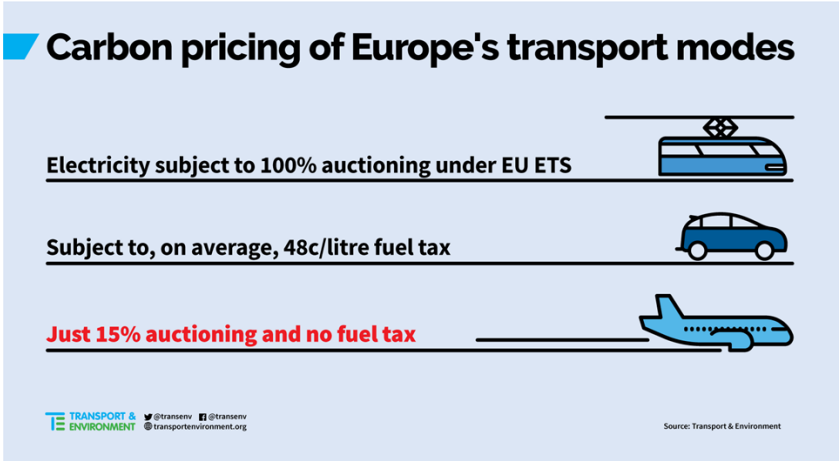
As mentioned in the Inception Impact Assessment, the Article 192(2) TFEU contains a specific passerelle clause to switch from unanimous voting to the ordinary legislative procedure for tax measures in the environmental field. This possibility is relevant, in particular, for the fight against

climate change and for the achievement of environmental policy goals. The Council's commitments in December 2019 to ensure the ETD's legal framework is updated, paves the way for the European Commission to get support from member states to unanimously agree on using this passerelle clause for the ETD revision.

Article 116 of the TFUE: another option to counter unanimity for tax

Article 116 TFEU, states that qualified majority voting under the ordinary legislative procedure is possible when it comes to taxation, if a proposal is meant to eliminate distortions of competition due to different tax rules being imposed by member states. This provision has not been used so far, but the European Commission should explore this possibility. Given that the outdated ETD framework, since 2003, differentiated tax treatments for energy products have been implemented across Member States, which could constitute "distortions" justifying the use of Article 116.

The ETD currently provides for taxation of fuel used for road and rail transport but not for aviation or maritime transport. Also, most of the production of fuel used by road and rail (diesel, petrol, electricity) is covered by indirect carbon pricing through the inclusion in the ETS. This difference in pricing mechanisms creates an uneven level playing field between these transport modes, as it inflates the cost of road and rail to the benefit of aviation & maritime. This situation is even more problematic in view of the EU's climate ambitions, as this distortion unfairly rewards more polluting modes of transport or more polluting fuels.



2. Different tools for different modes of transport

2.1. Aviation: finally ending its fossil fuel tax holiday

Aviation is one of the fastest growing greenhouse gas emitting sectors, with emissions expected to double or triple by 2050 but it still benefits from a tax holiday (fuel & VAT), a revenue shortfall of €39 billion a year. In order to reverse this growing trend of emissions, regulators should urgently introduce effective carbon pricing to encourage the use of cleaner alternative fuels or modes of transport by taxing cheap and dirty kerosene.

2.1.1. Ending the kerosene tax exemption

Currently, Art. 14 paragraph 2 of the Energy Taxation Directive (ETD) exempts fuel used for aviation from taxation. Under the direction of the European Commission's new President, Ms. Von der Leyen and as Vice President Mr. Timmermans stated in his answers to European Parliament questions, the ETD should be revised with the objective to **address the exemption rule for kerosene fuel taxation**. This should allow **for the introduction of an EU-wide kerosene taxation on intra-EU routes as well as departing from Europe**. In 2003, the ETD was revised to allow for bilateral intra-EU taxation of kerosene between two or more member states. This led in part to lift some fuel exemption provisions within new Air Service Agreements (ASAs) concluded as of then. This new revision of the ETD should permit kerosene taxation from flights departing from Europe as well as intra-EU, because this will help revise fuel taxation exemptions included in European ASAs further down the line as well.

In the event that all departing flights in Europe paid the ETD minimum tax on fuel uplifted, this would be equivalent to a CO2 price of €130/tCO2. A kerosene tax set at the EU minimum levels of taxation for motor fuels of 33 cents/litre would raise **€9.2bn a year** if applied to intra-EU aviation. A report for the European Commission found that taxing aviation kerosene sold in Europe would cut aviation emissions by 11% and have no net impact on jobs or the economy as a whole while raising almost €27 billion in revenues every year if applied to all inbound and outbound flights in Europe. The higher fiscal revenues generated by the tax would offset the negative effects on employment given the possibility of encouraging the creation of new jobs in other modes of transport, and as a result have negligible impact on employment and the economy.

Ending the kerosene tax exemption EU-wide is the best option, but given issues surrounding unanimity rules for taxation, there are also interim ways to address this fuel exemption pending unanimity through the bilateral approach.

2.1.2. Promoting the use of bilateral taxation agreements

The ETD allows two or more member states to implement a kerosene fuel tax for intra EU flights taking place between those countries, on the basis of a bilateral agreement. Member states (such as Sweden

and Denmark for example) could decide, through a bilateral agreement, to tax the fuel which is sold to aircraft operating to and from their countries, regardless of the operator's origin.

Kerosene taxation is allowed under international law: any EU wide or bilateral taxation scheme for kerosene is in compliance with the rules of the Convention on International Civil Aviation, as the Chicago Convention only forbids the taxation of fuel **on board** an aircraft on arrival in the territory of a state (Art. 24 of the Chicago Convention). It doesn't ban taxing fuel which is "**uplifted**", i.e. bought on the territory of an EU member state.

Bilateral taxation schemes need to address existing exemptions in Air Services Agreements (ASAs)[1]: ASAs are agreements establishing the conditions of air services taking place between agreeing states (such as the EU-US Open Skies Agreement). Some of them contain taxation exemption clauses, meaning that operators from foreign countries may not be taxed for the fuel used on intra-EU flights. However:

1. **A vast majority of current ASAs do not include these exemptions.** Since the adoption of European Regulation No 847/2004 aimed at bringing national ASAs in line with EU law, Member States agreed to seek the deletion or amendment of provisions in bilateral air service agreements that exempt aviation fuel from taxation[2].
2. **For those few ASAs which still exempt kerosene taxation,** the exemption can be removed or addressed by simple administrative procedures (including de minimis clauses to exempt them) or renegotiating arrangements.

The European Commission should issue guidance to member states on ways to implement bilateral or multilateral taxation agreements for kerosene, as this would in turn build momentum for taxing kerosene at the EU level.

2.1.3 Compatibility of kerosene taxation with the EU ETS

The only carbon pricing tool available to regulate aviation emissions today is the EU's Emission Trading System (EU ETS). Airlines are asked to surrender allowances under the ETS for their intra-EU carbon emissions but do not pay tax on their fuel. **However, participating in the EU ETS does not exempt entities in having to comply with other forms of environmental, climate or energy related taxes.** The EU ETS is often additional to the current tax structure in most countries.

According to the OECD Tax Database[3], in most countries, sectors that participate in the EU ETS are also subject to other taxes, mostly energy taxes. The overlap is larger for the electricity sector than for the

[1] Legal analysis of fuel taxation in Europe part 1 and part 2
[2] European Commission Decision 29/03/2005 on approving the standard clauses for inclusion in bilateral air service agreements between Member States and third countries jointly laid down by the Commission and the Member States
[3] OECD, 2016. Share of emissions priced and average price signals from taxes and ETS, all country data.

industry sector – but even in the industry sector 8% of the emissions in Denmark to over 50% of emissions for industry in Greece are subject to taxation complementary to the EU ETS. These measures have also contributed to emissions from the industry and electricity sectors to decrease by 3.9% while aviation continued to grow by 4.9% in 2018. **This shows how the favourable treatment of the aviation sector counters efforts from other sectors to reduce overall emissions in the ETS.**

Climate policies also do not exempt ETS sectors. Many countries have planned phasing out coal plants such as the Netherlands, Austria, Denmark, the UK and France. The fact that coal fired power plants take part in the EU ETS does not free them from obligations stemming from additional climate policies, and the same should apply for the aviation sector.

2.2. Shipping: ETS more effective carbon pricing than an EU-wide fuel tax

With 140 million tonnes of CO2/year[4] EU shipping contributes more to climate change than 20 EU member states' entire economies but still benefits from €24 billion/year fossil fuel tax exemptions under Article 14(1)(c) of the EU Energy Tax Directive. As a matter of principle, tax exemptions under the ETD should be removed. Despite this, to implement effective carbon pricing to rein in the sector's emissions, extending the EU ETS to cover international shipping should be prioritised. The EU Emissions Trading Scheme (ETS) should be complemented with additional command and control measures, such as operational CO2 standards and zero-emission berth standards to reduce emissions and drive the uptake of sustainable zero carbon fuels.

2.2.1. Taxation of marine fuel vs ETS carbon pricing

By signing the Paris Agreement, the EU committed to "economy wide" emissions reduction efforts, applying to all sectors, including international shipping. Therefore, Article 14(1)(c) of the EU Energy Tax Directive which exempts marine fuel from taxation, should be revised in order to ensure the shipping sector fully contributes to Europe's climate targets.

Even though a removal of such a ban would be a politically and ethically progressive policy choice, taxation of marine fuel sold in the EU would **not be a practically effective way of implementing (indirect) carbon pricing in the shipping sector.** This is because of **tankering**. Tankering occurs when ships avoid refuelling at expensive bunker ports and instead choose to refuel at cheaper fuelling ports (inside the EU or outside the EU). This would create an insurmountable challenge for the practical implementation of national or EU taxation of marine fuel, as there is a strong risk of tax avoidance by ships refuelling in non-taxed bunker ports.

For that reason, T&E strongly recommends implementing direct carbon pricing for international shipping by including all EU-related shipping (based on the EU MRV scope) into the EU ETS. Unlike

[4] EU THETIS MRV, 2019

marine fuel taxation, avoidance under the EU ETS is less likely according to the Commission's impact assessment in 2013. As opposed to fuel taxation which is levied at the point of fuel sale, the EU ETS would rely on activity-based data and cover ships greenhouse gas emissions on the journeys to/from/within the EU ports regardless of the point of fuel sale.

2.2.2. Taxation of shore-side electricity supplied to ships

The ETD also has implications on the supply of zero-carbon energy, notably shore-side electricity (SSE) to ships for auxiliary or main propulsion.

Article 14(1)(c) exempts fuel from taxation that is used in Community waters and Article 15(1)(f) extends that to inland waterways and to electricity produced on board a ship (allowing ships to use bunker fuel at berth without taxation). Therefore "energy products" supplied to ships whether for propulsion purposes or for general energy purposes when at berth, is exempt from taxation.

Article 14(1)(c) however only exempts "energy products", which under the ETD does not include electricity. There is no clear reason for electricity to be excluded from the taxation exemption, especially as the clear intent of the ETD was to exempt any substance that provides energy to shipping. Given that in 2003, the ETD did not contemplate that electricity would be supplied to ships, all EEA countries have assumed that ETD excludes SSE from tax exemptions and several member states have used Article 19 of the ETD to implement temporary tax exemptions for SSE.

However, the fact that the ETD is unclear on this point and SSE remains taxed as per default, in most of the cases the continued on-board combustion of dirty marine fuels at berth remains cheaper than using SSE. This appears to dissuade ships from switching to SSE and ports making relevant infrastructure available for use of ships. It is important for the revision of the ETD to ensure SSE remains an affordable and economically preferable option through a favorable tax regime.

Temporary tax exemption of SSE for ships could be considered as a transitional option to encourage the uptake of electricity use at berth and battery-electric propulsion technologies. However, from the broader economic and climate justice view point, there is no reason to provide ships permanent tax exemptions, including for SSE, while all other sectors are required to pay their fiscal and climate contributions.

2.2.3. The need for additional command & control measures for shipping

Even though carbon pricing via ETS and temporary tax exemption for SSE under ETD would go some way in levelling the playing field between fossil fuels and sustainable zero-carbon carbon alternatives, further command and control measures would still be needed to address market imperfections.

We believe that two types of command and control measures are suitable to be implemented at the Union level in order to accelerate the reduction in maritime emissions and drive the uptake of

sustainable zero-carbon marine fuels/energy: operational CO2 standards applied to existing fleets, and zero-emission berth standards - both under the scope of the MRV Regulation (EU) 2015/757.

2.3. Road transport & promoting zero emission mobility

2.3.1. Reflect CO2 impact of fuels in taxation rates for diesel, petrol & natural gas

- **Harmonise diesel & petrol taxation**

In most countries diesel fuel has always been taxed at a lower rate since it was predominantly used by commercial vehicles. By applying two different tax rates for diesel and petrol, governments have maximised stable fuel tax revenues from petrol car drivers whilst protecting the commercial road haulage sector from excessive costs and from competition from neighbouring countries with a lower diesel rate. When the share of diesel passenger cars remained low, this taxation framework worked effectively; but this is no longer the case.

The ETD currently differentiates the minimum tax rates between diesel and petrol, in favour of diesel, as they are today respectively 33cts/L for diesel and 36cts/L for petrol. Across most European countries, diesel taxes are currently 10%-40% per litre lower than petrol taxes, with the biggest diesel bonuses in the Netherlands (37%) and Greece (41%). The average gap in tax levels for diesel and petrol paid by motorists is currently €0.12/l which is 27% lower than petrol per unit of energy.

But, there is an urgent need to update these rates, as there is no justification to treat diesel differently. **Tax rates should be relative to energy content or CO2 emissions per litre, which are around 10% and 16% higher, respectively, for diesel than petrol**. The revision of the ETD could also allow EU countries with wider diesel/petrol tax gaps longer time periods to harmonise their fuel tax rates.

- **Establish minimum natural gas tax rates for CNG & LNG use in transport**

The use of natural gas in transport delivers negligible climate benefits, if any. However, natural gas in transport is considerably undertaxed in comparison to petrol or diesel. The current ETD effectively gives member states the possibility to apply total or partial exemptions or reductions in the level of taxation of natural gas and LPG used as transport propellants. For example the minimum excise duty rate for natural gas is €2.60/GJ while Belgium applies a zero rate by referring to the current ETD, Article 15(1)(i). This flexibility needs to be phased out without any delay.

According to a study commissioned by T&E, natural gas is taxed 90% below petrol and diesel. Considering its climate impact and the existence of cleaner alternatives, it should be taxed at the same rate as petrol or diesel based on energy content.

2.3.2. Put an end to European fuel tax tourism for trucks

Fuel tax tourism has been growing in Europe over the past decades for the commercial haulier sector, because of the ETD's failure to address market developments. For small, central EU member states it is extremely attractive to tax diesel for trucks at the minimum rate because it encourages hauliers to fill up their tanks on their territory, boosting member states' revenue.

Eight member states also offer the option for hauliers to partially recover the diesel tax they pay. They typically do this for two reasons. The first is to respond to pressure from the haulage industry complaining about competitive disadvantages vis-a-vis foreign competitors. The second is related to keeping diesel taxes for trucks low, in order to seduce more foreign trucks to fill up at national petrol stations, securing domestic tax revenue from foreigners.

This tax distortion is not only **socially harmful**, as it penalizes those member states applying higher rates and therefore pushing them to find other forms of revenues, such as higher labour taxes or spending cuts. But it is also **environmentally absurd** as it creates a competitive race to the bottom for fuel taxes, countering the whole principle of the ETD and resulting in continuously growing emissions.

In 2018, trucks paid on average €0.05 below the diesel tax rate cars paid. Truck diesel tax rebates amounted up to €2.4bn in 2018, up from 0€ in 1999. The number of countries giving fuel tax rebates to hauliers has gone up from only Italy in 2000 to 8 countries (Italy, France, Spain, Romania, Belgium, Hungary, Ireland, Slovenia).

Our long-term recommendation is for EU regulators to really solve the diesel tax competition issue without needing harmonised tax rates and actually leaving member states freer than today. A system like the International Fuel Tax Agreement (IFTA) could work in Europe, through the use of the tachograph. Under the IFTA, truck operators (hauliers) record distance travelled and fuel consumed within each state/province (jurisdiction). Tax paid where fuel is purchased is later reconciled against actual use. Thanks to this reconciliation process, hauliers obtain a rebate from some jurisdictions and pay additional taxes to others. Significant differences in tax rates between neighbouring states/provinces are sustained under this system because the haulier ultimately pays tax where transport actually takes place.

The EU can do the same. What needs to be implemented is the automatic registration of diesel use per truck per country and a payment system. In technical and administrative terms this is not difficult. But it is a change, and a change that requires political commitment.

2.3.3. Tax biofuels based on their CO2 impact

Article 16 of the ETD allows member states not to charge fuel tax duties to the fraction produced from biomass. Some member states like Finland and Sweden charge a reduced fuel tax.

But not all biofuels are created equal. A European Commission study has shown how some biofuels are worse than diesel when taking into account CO2 emissions. Food-crops grown on land are used to produce biofuels and are associated with negative indirect land use change impacts (ILUC). When these indirect impacts are accounted for, a majority of current food-based biodiesel at EU level are worse for the climate than fossil diesel. The European Commission has signalled at several occasions the necessity to stop providing public support to food based biofuels and the current state aid guidelines for environmental protection require the end of support to food-based biofuels after 2020.

It is key that the tax exemption for biomass based fuels should not continue and the ETD should be aligned with current commitments to ensure that food based biofuels do not receive further public support. Public support should rather focus on cleaner alternatives, such as advanced biofuels from true waste and residues, provided they deliver substantial greenhouse gas savings and appropriate sustainability criteria are adopted.

2.3.4. Promote electromobility through tax rebates

The ETD should only allow member states to give tax rebates or incentives to zero emission (electric) corporate fleets/company cars, for example by allowing discounts on the electricity consumption of large Electric Vehicle (EVs) fleets that use smart charging and bidirectional systems (V2G) for flexible & efficient charging. In addition, electricity used in vehicles should be taxed the same as the rest of electricity, in order not to penalize households equipped with a charging point. Smart technology enabled charging points (smart charging & V2G) lead to more efficient charging of EVs, and allow demand response mechanisms that are essential to balance the electricity grid.

2.3.5. Include indexation on inflation

In 2018, the average road fuel tax paid by motorists and hauliers, excluding VAT, was €0.54 which, corrected for inflation, is 19% below the 2000 level of €0.67/liter. The ETD is partially responsible for this drop, as it did not include a periodic review of minimum tax levels at an EU level. Member states were therefore not obliged to keep fuel taxes linked to inflation.

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Further information

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