



5 November 2009

### **CONTRIBUTION TO THE REVISION OF THE ENERGY TAX DIRECTIVE**

During the stakeholder meeting on the revision of the Energy Tax Directive (ETD) of 28 September 2009, the European Commission invited all participants to send comments by the end of October on the introduction of a European framework for carbon taxation.

BUSINESSEUROPE recognises the need to reduce greenhouse gas emissions across the economy in accordance with the 2020 commitment. We also consider that it is important to undertake action to reduce emissions from non-ETS sectors in all EU Member States to avoid distortions in the market.

Member States have already implemented a number of policy measures to reduce emissions in the sectors not covered by the ETS (services, transport, small industrial installations not covered or opted out of the ETS, agriculture and households) and are currently considering further measures. These need to be properly evaluated as to their cost efficiency in reaching the environmental objective and to the need for an additional climate instrument at European level.

We encourage the Commission to first address fundamental issues to do with the revision before tackling the details. Given that the Commission has not yet established what the criteria for equivalent measures should be, and Member States have not had much time to design and implement such measures since the ETS directive was finalised, it could be counter-productive to proceed with a minimum carbon tax at this stage.

If the Commission is to propose a European carbon tax framework, the comments set out below must be reflected. This means in particular no overlap with already existing or envisaged national measures for reducing emissions outside the ETS. In any event, the overall tax and compliance burden for companies must not increase. This means that the carbon tax should not cover installations in scope of the EU ETS (even those receiving free allocations), a carbon tax must be compensated through the reduction of other business taxes and should be conceived to be efficiently combined with the requirements of the EU ETS and other climate change related directives. Such carbon tax rate should be set with a view to reach environmental objectives and not to raise revenue.

This note first addresses the issues of key concern for the business community and then replies to the more specific questions.

1. No taxation of installations covered by the ETS
2. No taxation of emitters covered by equivalent measures
3. Mirror free allocation of allowances in tax system
4. Use of offset mechanisms
5. Expected administrative costs
6. Specific questions raised by DG TAXUD



## **1) No taxation of installations covered by the ETS**

- No carbon tax on installations covered by the ETS whether or not allowances are allocated free of charge

### **Background**

Under the EU ETS, full auctioning of emission allowances will be phased in from 2013. Installations from sectors deemed to be exposed to a significant risk of carbon leakage will receive relatively more free allowances than other sectors. Free allowances will in principle be allocated based on product-specific benchmarks for each relevant product.

The starting point for the benchmarks is the average of the 10% most efficient installations in a sector. The benchmarks will be multiplied by historical production to calculate the amount of free allowances to be allocated and in order to ensure a declining cap, a correction factor will be applied.

For carbon leakage sectors, the free allocation will be multiplied by a factor 1 (100%) while for other sectors the allocation will be multiplied by a lower figure (0,80 in 2013, and reduced every year to reach 0.30 in 2020). Nevertheless, exposed sectors are not 100% exempt from the auction costs. Because of the over-all EU CO<sub>2</sub> cap, and the fact that the benchmarks will be stringent, the ETS is not for free – also for the most efficient installations.

### **BUSINESSEUROPE position**

There must be no CO<sub>2</sub> tax on installations/final energy consumption (electricity) covered by the ETS (including free allowances):

- CO<sub>2</sub> taxation on EU ETS installations would raise production costs without generating additional emission reductions. Therefore, installations and final energy consumption (electricity) already covered by the ETS must be exempted from the CO<sub>2</sub> tax to avoid economic inefficiencies.
- A CO<sub>2</sub> tax on EU ETS installations that receive free allowances to compensate for carbon leakage will create the negative effect on competitiveness that free allocation aims to avoid.
- Even when receiving (partly) free allocation of allowances, the installations will face a price on carbon emissions: the cap on emission allowances will decrease by 21% until 2020 and companies outside a narrow efficiency benchmark will have to partly buy their allowances already in 2013.
- Exemptions from a carbon tax for ETS installations as foreseen for the revision of the Energy Tax Directive should not be challenged by the State Aid guidelines.



## 2) No taxation of installations covered by equivalent measures

- Mix of equivalent measures to the carbon tax at the national level to (a) allow small installations to opt out from ETS and (b) cover emissions from non-ETS sectors

### **Background**

The term “equivalent measure” is normally used with reference to the ETS Directive (2009/29/EC, art. 27) which stipulates that small installations can be excluded from the ETS if they are subject to equivalent measures or “*measures that will achieve equivalent contribution to emission reductions*”. According to point 11 of the pre-amble “*Such measures could include taxation, agreements with industry and regulation.*”

Under the current Energy Tax Directive, Member States may apply tax reductions in favour of energy intensive businesses and “*where agreements are concluded with undertakings or associations of undertakings, or where tradable permit schemes or equivalent arrangements are implemented, as far as they lead to the achievement of environmental protection objectives or to improvements in energy efficiency.*”

### **BUSINESSEUROPE position**

Voluntary agreements between industry and government at national level are the preferred equivalent measure for European business. To mirror the ETS Directive, such voluntary agreements should lead to commitments for concerned industries in terms of CO<sub>2</sub> reduction (which implies a monitoring and penalties system).

Where national schemes have been proved to meet challenging energy and emission targets, e.g. Climate Change Agreements (see [annex](#)), they should be approved as equivalent measures. Companies exempt from the ETS and subject to other equivalent measures than taxes, should be exempted from a CO<sub>2</sub> tax. Small installations not covered by the ETS Directive, as they do not reach the thresholds in Annex I should also be eligible for equivalent measures and exempted from the carbon tax.

Where national schemes for reducing emissions in the non-ETS sectors are in place, countries should be allowed to opt out of from the EU CO<sub>2</sub> tax framework. Existing national CO<sub>2</sub> tax regimes should be recognised as equivalent for emissions covered by the ETD framework as long as they respect the ETD provisions. Some Member States have high energy taxes on environmental grounds. If national energy tax rates are above the combined EU minimum of energy and carbon taxation, this should trigger exemption from the carbon tax.

### **Other measures suggested:**

- Allow sectors to opt into the EU ETS.
- Direct emission reduction measures to the extent possible and economical useful improvement potential and not linked to specific technology: implementation of energy efficiency improvements, efficient use of installations, changes of fuel or raw materials, etc.
- Indirect emission reduction measures to the extent possible and economical useful: reduction of electricity consumption, e.g. by replacing purchased electricity with the self-generation of high-efficiency energy (i.e. cogeneration of power and heat).



- Implementing energy management systems in a similar scheme to environmental management systems, establishing possible and economical useful improvement goals in the installation's energy management which would have to be suitably audited and verified.

### 3) Mirror free allocation in tax system

- ➔ How can the free allocation of emission allowances for ETS installations be replicated in the European framework for carbon taxation?

**Background** - See above (1).

#### **BUSINESSEUROPE position**

We welcome the fact that the European Commission recognizes the need for adapting policy instruments to prevent carbon leakage, i.e. in the transition as long as other regions do not have carbon constraints and resulting costs for competing sectors and companies. To mirror the EU ETS free allocation, we propose the following options:

1. For small installations from ETS sectors: Exempt sectors on the ETS carbon leakage list from carbon taxation. Ideally, tax reductions for individual installations would be in line with the % of free allocation from sectoral or sub-sectoral benchmarks or other fall back options. Given that allocation of emission allowances to installations in carbon leakage sectors is not completely free, the reduced CO<sub>2</sub> tax might be computed based on the estimated ETS cost (e.g. % of allowances that the ETS companies will have to buy).
2. For installations from non-ETS sectors: develop quantitative criteria that allow to identify which non-ETS sectors are exposed to the risk of relocation under a carbon tax and exempt them based on the efficiency of the processes.
3. Implement a transitory period for installations covered by the carbon tax and not exposed to carbon leakage in line with ETS auctioning rules: a linear increase with 20% of CO<sub>2</sub> tax in 2013, 70% in 2020 and 100% in 2027.

Further exemptions might be needed to prevent distortions of competition in specific situations. BUSINESSEUROPE believes there is no case for abandoning certain exemptions such as the existing Energy Tax Directive exemption for mineralogical transformation to ensure that these sectors remain competitive compared to sectors receiving free allowances under the ETS.

Additional observation: the ETS covers installations, but the Energy Tax Directive (ETD) makes reference to processes. This could limit the efficient combination of the ETS and the ETD. We urge the Commission to consider alternatives to avoid creating excessive compliance requirements for companies and governments. This issue has been considered in the draft of the French finance bill: installations of energy intensive industries or industries using biomass as fuel are exempted from the French carbon tax provided that they will be subjected to ETS in 2013.



#### 4) Use of offset mechanisms

→ how can the use of offset mechanisms for ETS installations be replicated?

##### **Background**

Companies can convert international carbon credits from Joint Implementation projects or through the Clean Development Mechanism into allowances that can be used for compliance under the EU ETS. Moreover, 50% of EU ETS auctioning revenues should be earmarked to environmental improvements through incentives for eco-innovation, carbon capture and storage projects, renewables or reforestation (Art. 10.3 ETS).

##### **BUSINESSEUROPE position**

A similar offset mechanism should be envisaged for a carbon tax to ensure cost-efficiency and a level playing field. Therefore, we strongly support to keep Art 17a of the draft proposal for revision of the ETD which foresees an exemption from CO<sub>2</sub>-related taxation for CO<sub>2</sub>-reducing investments (up to 70% of investment).

International offset could be implemented through widening the scope of this article also to international emission reduction projects. With regard to respecting the Treaty's freedom of establishment, article 17a should also allow for offsetting the carbon tax by reducing emissions in installations in another Member State.

##### *"Article 17a*

1. Until 31 December 2020, Member States shall exempt from CO<sub>2</sub>-related taxation the use of energy products, for purposes other than those referred to in Article 7, in a unit which has been subject to qualifying expenditure.  
  
Households and organisations recognised as charitable, as referred to in Article 15(1)(h), shall not be eligible for the exemption.
2. The exemption shall apply following the putting into operation of the asset or the improvement leading to the reductions of CO<sub>2</sub> emissions. The amount of the exemption shall not exceed 70% of the qualifying expenditure. Until this limit is reached, qualifying expenditure not yet compensated by tax exemptions under the present Article granted during the preceding calendar year or years shall be carried forward to the following calendar year, but not beyond 2020.
3. Qualifying expenditure shall be capital investment expenditure, excluding VAT, incurred after 2010 on the acquisition or substantial improvement of an asset or assets, provided that this acquisition or improvement leads to a reduction of at least 20% of CO<sub>2</sub> emissions of the unit concerned, as compared to the emissions prior to the acquisition or improvement.
4. The beneficiary must prove the amount of the expenditure and present a sufficiently reliable estimate, based on appropriate calculations and documentation, of the reductions to be obtained through the acquisition or improvement.



Moreover, art. 17.1(a) should be adjusted to take into account the cost of carbon taxation as a factor determining energy-intensive business. Currently, either the purchase of energy products and electricity must amount to at least 3.0% of the production value or the *national energy tax payable* amounts to at least 0.5% of the added value for a business to qualify as energy-intensive and to be eligible for tax reductions. The cursive part should be amended to “national energy and carbon tax payable”.

#### 5) Expected administrative costs

→ on the basis of the current draft for revision of the Energy Tax Directive: what are the expected administrative costs

#### Background

Based on Commission presentation: “*Administrative burden is a non-issue for business*” of 28 September 2009.

#### BUSINESSEUROPE position

A high level assessment indicates an additional administrative cost of at least €50 M (one-off to reset the systems) and additional cost of product analyses of some €1,5 M / year if the reporting fundamentals change from volume and weight to “CO2 factors” and “GJ”. Mitigation of some of these costs is possible if the Commission would provide standard conversation factors and reporting system fundamentals would not need to be changed to cope with “CO2 factors” and “GJ” rather than with volume and weight.

These costs do not include the potential additional compliance and pre-financing burden that occurs from the fact that the carbon tax is introduced next to the EU ETS. According to the Commission, the carbon tax will be handled like an excise duty, e.g. collected by the supplier for the tax authority. It is unclear how the supplier should make the difference between different sizes of installations, one inside ETS and one outside when providing the company with energy.

Moreover, in case where the tax would be recovered by energy suppliers, important changes in current reporting and invoicing systems might be required since the scope of consumers subject to the taxation might evolve and exemptions / derogation processes must be entered into existing IT systems. It is therefore not possible for the Commission to conclude so quickly on the non-issue of administrative costs and detailed impact assessments should therefore be run to analyze the question in depth.

Moreover, on the basis of such assessments, appropriate measures should be designed in order to provide for cost recovery mechanisms or upfront exemptions for fuel and energy supplies to sectors covered by the EU ETS. A refund mechanism would require such sectors to pre-finance the carbon tax. This is a cost that most installations are either already bearing through the EU ETS or should not have to bear to avoid carbon leakage. Such inefficiencies should be avoided, especially in the current financial climate. Finally, a transition period would be needed in order to allow companies sufficient time to implement the new modalities.



## 6) More specific questions raised by DG TAXUD

- i. Mitigation measures in the tax system (point 3 of the agenda: how could a tax be designed to mirror free allocation of allowances?) → *reply see above*
- ii. 50% electricity rule in Article 2(4) of the Energy Taxation Directive. Any use of that provision? *This rule is important for the production of industrial gases in air separation plants (e.g. oxygen, nitrogen) which are (a) used directly by industrial installations that need industrial gases for production purposes and (b) by companies that exclusively sell industrial gases to third parties/customers. It is also important for cold stores and ice works, used e.g. in the food industry.*
- iii. Products under CN code 2705 - for which sectors are these relevant? *Such products are relevant for nearly all base material industries, i.e. chemical, steel and petroleum industry.*
- iv. Taxation of energy products and electricity: are there any specific situations of dependency on a particular product in a particular situation to be aware of?
  - The automotive sector strongly depends on the efficient diesel engine to meet European CO<sub>2</sub> targets and lower CO<sub>2</sub> emissions from road transport. Such targets have recently been agreed for 2012/15 as well as for 2020. Without a significant diesel share in the European fleet, it is unlikely that these targets will be met.
  - The refining sector is strongly influenced by the balance between gasoline and gasoil demand. Favourable tax rates for diesel versus gasoline have led the EU to become heavily dependent on imported diesel and long in gasoline, creating a potential risk to long term security of supply. This increased diesel production is also driving up refining emissions.
  - Furthermore, the increase of the circulating parc of natural gas vehicles is essential for the development of the refilling stations network which could be used in the mid term as infrastructure for biomethane/mixture biomethane-hydrogen coming from renewables.
  - Therefore, any new EU initiative on energy taxation should consider these elements and reflect a holistic and integrated approach, in line with the Council Conclusions of 28 May 2009 on an integrated approach to a competitive and sustainable industrial policy in the European Union.
  - Finally, the fuel part, consumed in cogeneration units (combined production of electricity and heat), which is used to produce electricity must have the same exemptions as the fuel used to produce electricity by the power generators. Externalization of processes to another sector should not lead to higher taxation if the use of energy products is initially exempt. In other words, taxation should be neutral and not affect economic decisions.



### **Annex: National equivalent measure: example of the UK Climate Change Act**

The UK Climate Change Act set provisions to establish a national level cap and trade system for non-ETS sectors. The scheme will be introduced in April 2010, with the capped phase starting in 2013. Around 5000 large businesses and public sector organisations will be included in the scheme (the threshold is 6000 MWh during 2008).

Each year participating organisations will need to buy allowances (priced initially at £12 per tonne) for their predicted energy use over the next year. At the end of that period they will report their emissions for that year and surrender the corresponding number of allowances.

Later on they will be ranked in a league table according to how far they have reduced their energy use against their own baseline energy use. Participants will then receive a payment from government based on their ranking in the league table, paid for through the sale of allowances.

The potential cost to companies will increase as the scheme matures as the margins of the recycling payment gear up year on year. The cost will vary quite significantly to participants depending on the size of the organisation and how energy-intensive they are. Because the scheme is designed to encourage energy efficiency measures which generally have a positive Net Present Value, the Government has estimated that participants as a whole will save £1billion by 2020. The cap is not yet set, but Government has also estimated that the scheme can reduce emissions by 4MtCO<sub>2</sub> by 2020.

The UK business federation CBI supports this scheme because it is designed to encourage businesses to use energy more efficiently and is not a revenue raising measure. It is also designed to incentivise those businesses for which energy costs are immaterial to think carefully about their energy consumption, without inflating those energy costs through a carbon tax.

There are other cost-efficient equivalent measures for instance in Belgium and the Netherlands. We aim to send further contributions on these measures shortly.