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Designing environmental taxes to promote biofuels from a State aid perspective

The impact of the Energy Taxation Directive on assessing selectivity of the
Swedish and Finnish energy taxation systems

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Outline of my presentation

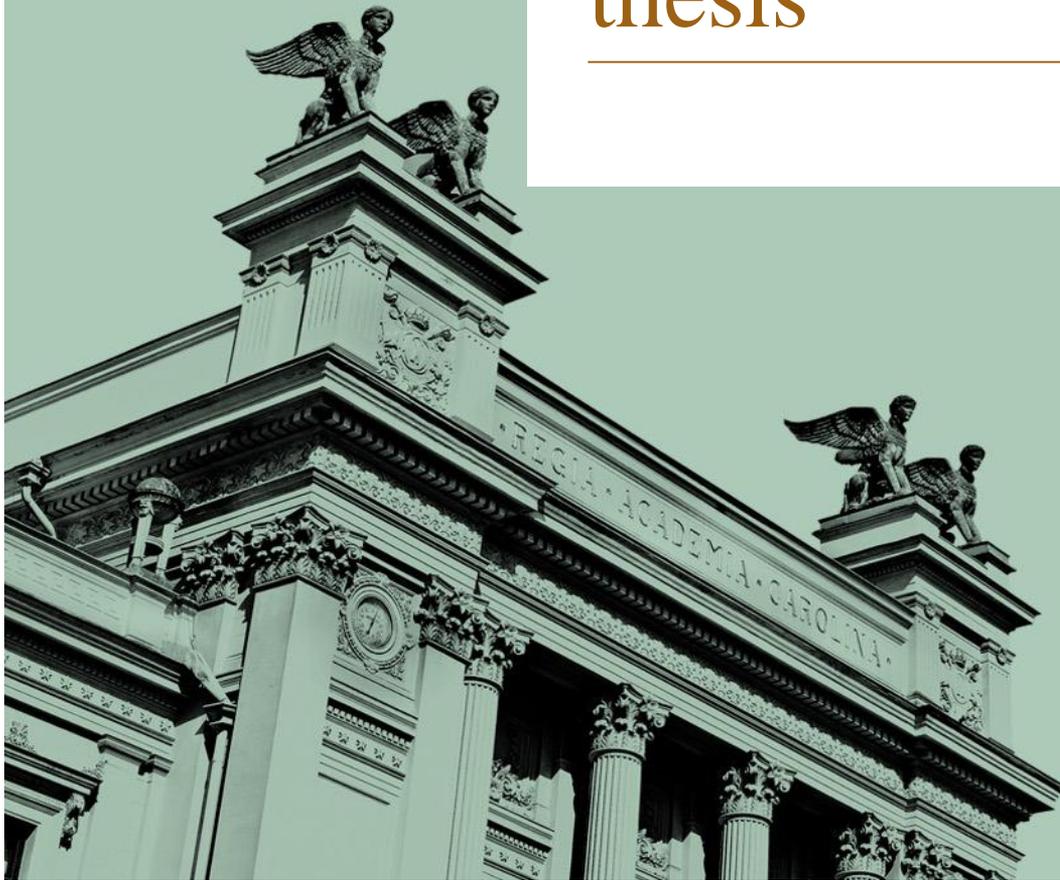
- Background and aim of the thesis
- The notion of State aid – the selectivity analysis
- The Energy Taxation Directive (ETD) and the Swedish and Finnish energy taxation systems
- The impact of the ETD on the selectivity analysis of the Swedish and Finnish energy taxation systems
- Conclusions and findings





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Background and aim of the thesis



Background (the broader perspective)

Paris Agreement



Climate targets at EU level



Renewable Energy Directive (2009/28/EU)

- 10 % renewable energy in transport by 2020
- Sustainability criteria (prerequisite for financial support)
 - » *Minimum GHG emission savings (at least 50 %)*
 - » *Land-use criteria*



Background (the Swedish perspective)

Net-zero emissions by 2045 → Individual milestone target for the **transport sector** (70 % reduction of GHG emissions by 2030 compared to 2010)

- Electrification + substitute fossil fuels for biofuels in existing cars
- Tax exemptions for sustainable biofuels (to become competitive and to promote its use)
- Swedish tax exemptions considered to constitute **State aid** → dependent on temporary approval decisions from the European Commission under the EEAG
 - **Prohibition on overcompensation** (biofuels may not be cheaper than fossil fuels at the pump)

Swedish government: *“State aid rules should contribute, rather than counteract, the transition to a carbon free society and the implementation of the Paris Agreement”*



...

The EEAG only a problem if tax reliefs are classified as State aid in the first place

- Swedish carbon tax and energy tax reliefs = State aid
- Finnish carbon tax and energy tax reliefs = no State aid

- Why?



Energy Taxation Directive (ETD) (2003/96/EC)

- Harmonises taxation of energy products (eg motor fuels) = Finnish and Swedish carbon taxes and energy taxes considered harmonised taxes
- Unclear how the ETD impacts on the State aid assessment



Aim of the thesis

Aim:

- Study how the ETD influences the State aid assessment of the taxation of biofuels in the Swedish and Finnish energy taxation systems

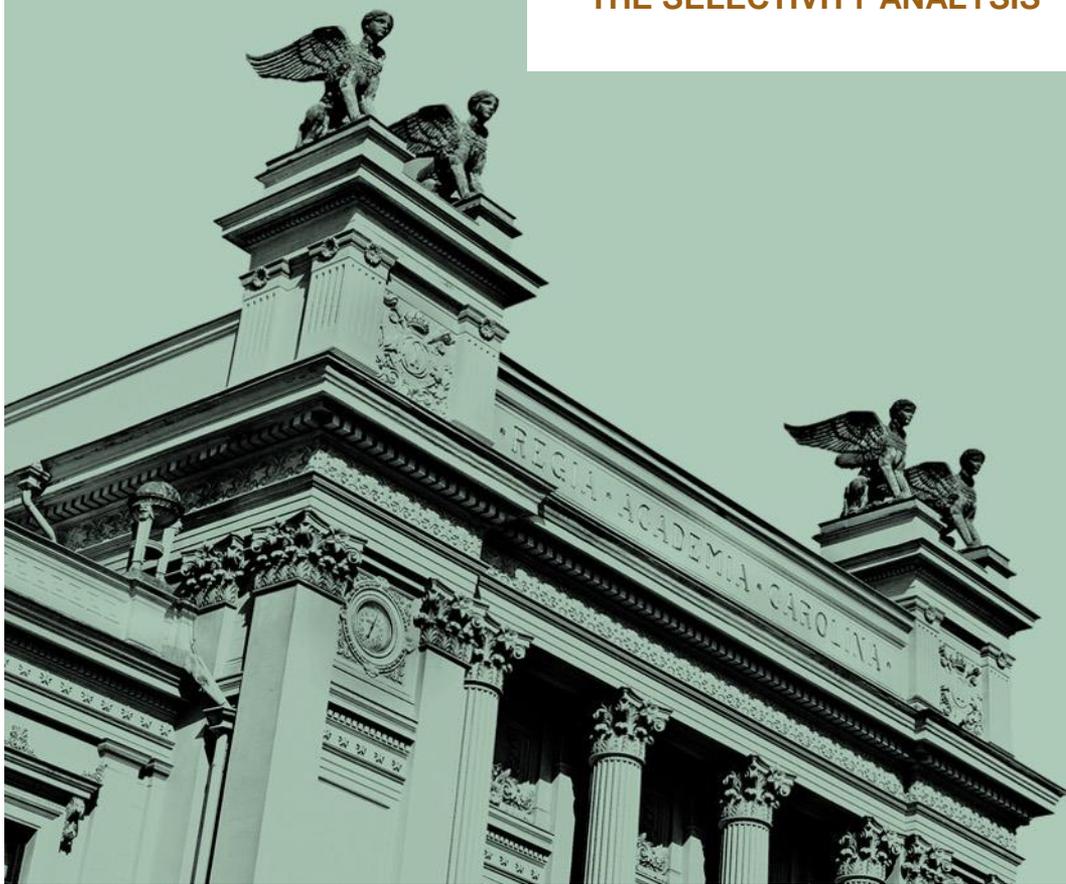




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The notion of State aid

THE SELECTIVITY ANALYSIS



The notion of State aid

Article 107(1) TFEU: *“Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market”*

- Granted by the State or through State resources
- **Selective advantage**
- Distortion of competition and effect on trade between Member States

State aid is prohibited unless approved by the EU Commission under Article 107(2)-(3) TFEU or any of the Commission’s guidelines (such as the EEAG)



The selectivity analysis

Three step test developed in the CJEU´s case-law to assess selectivity:

1. Identify the “normal” tax system – a reference system
2. Derogation from the reference system – comparability assessment (prima facie selectivity)
3. Justification by the nature and logic of the system

Selectivity analysis = discrimination test



Environmental objectives and selectivity

Can Member States rely on environmental objectives to justify differential (tax) treatment of undertakings?

- Yes, they can. However, only if the environmental objective is **internal/integrated** into the tax regime (cf environmental levies/taxes)
- On the other and, if the tax measure is based on policy objectives unrelated (external) to the broader tax system (eg corporate income tax) = **selective**

Key cases: *British Aggregates* (T-210/02 RENV) and *ANGED* (C-233/16)





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The Energy Taxation Directive (ETD) and the Swedish and Finnish energy taxation systems



The Energy Taxation Directive (ETD)

- The ETD was adopted in 2003 as an internal market directive
- **Objective** → proper functioning of the internal market for energy products and electricity (recital 2 and 3)
- Minimum harmonisation directive
 - Minimum rates for taxation of energy products used as motor fuels, heating and electricity
 - Liquid motor fuels (diesel and petrol) → minimum rates based on **volume**
 - Motor fuels for which no minimum rate is set (ie **biofuels**) → taxed at the rate of its equivalent motor fuel (on the basis of volume)
 - ❖ For example: **biodiesel = diesel; ethanol = petrol**



Proposal to revise the ETD in 2011

Taxation based on volume creates incentives in contradiction with the EU's energy and climate objectives

Commission proposed to split minimum rate into two parts:

- One part based on **CO2 emissions** (minimum carbon tax)
- One part based on **energy content** of the energy product

Proposal withdrawn in 2015 → **no unanimity** in the Council



Article 16 of the ETD

Possibility to apply **tax reliefs** for **biofuels**

- **Art 16(2):** Tax reliefs "may be lower than the minimum levels [set for fossil motor fuels]"

Art 26(2): Any tax reliefs or exemptions authorized by the ETD may constitute State aid

- Prohibition on overcompensation from the EEAG incorporated into **Art 16(3)**
- Tax reliefs under Art 16 presumed to constitute State aid → derogation not justified by the nature and logic of the ETD



The Finnish energy taxation system

Finnish energy taxation system → two separate components:

- **Energy content tax**

- Applied in proportion to the energy content of the fuel

- **CO₂ tax**

- Levied on carbon emission, based on a **life cycle analysis** for both biofuels and fossil fuels
- CO₂ tax for **biofuels** based on default values for expected life cycle emission savings set out in the RED
 - Unsustainable biofuels (cf sustainability criteria) = no CO₂ tax exemption
 - 1st generation biofuels = 50 % CO₂ tax relief
 - 2nd generation (advanced) biofuels = full CO₂ tax exemption
- CO₂ tax for **fossil fuels** → not only T2W, but also W2T



The Swedish energy taxation system

Swedish energy taxation system → two separate components:

- **Energy tax**

- Applied (almost) in proportion to the energy content of the fuel
- High-blended and pure biofuels fully exempt from energy tax

- **CO₂ tax**

- Levied on *fossil* carbon emissions
- Not levied on (sustainable) biofuels





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The impact of the ETD on the selectivity analysis of the Swedish and Finnish energy taxation systems



Assessing selectivity of the Swedish CO₂ tax scheme

Key question: *Which* regime's internal objective/logic is the relevant yardstick?

- Can only be the ETD's internal logic that is relevant
- If not, the Swedish CO₂ tax scheme should not involve State aid

ETD's internal logic/objective

→ taxing fossil fuels and biofuels equally on the basis of volume

- Biofuel tax relief **not internal** to the logic underlying the ETD = tax differentiation not justified by the nature and logic of the tax

Swedish CO₂ tax's internal

logic/objective → taxing fossil carbon emissions

- Biofuels and fossil fuels **not** comparable as only fossil fuels emit fossil carbon emissions = not selective



Assessing selectivity of the Finnish energy taxation system

Energy tax and CO₂ tax differentiation *justified by the nature and logic of those tax systems* (Finnish preparatory work) → Accepted by the Commission (?)

- Reasonable if the yardstick was the logic of the national taxes
 - **Energy tax:** Taxation on the basis of energy content
 - **CO₂ tax:** Taxation on the basis of CO₂ emissions in a life cycle perspective
- **However** → Logic/objective of the ETD, not the national taxes, that is the relevant yardstick
- Logic/objective of the national taxes irrelevant

Finnish energy taxation system = State aid (in my opinion)



Conclusions and findings

- Assessing selectivity of (certain) taxes very unforeseeable (subjective?!)
- ETD old and outdated → the Commission wish to see it revised
- (Politically) controversial to "ruin" a neutral (and very sound) tax system with an old and outdated directive?

The ETD is the main problem, not Article 107(1) TFEU





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Thanks for listening!

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Link to my thesis: <https://lup.lub.lu.se/student-papers/search/publication/8983529>

