Revision of the Energy Taxation Directive – Roadmap Consultation September 2020

1. EC assessment on Energy Taxation

Iberdrola, a Spain-based international energy group and the leading producer of wind power in the world, as well as active player in the area of infrastructures development, notable smart grids and electric vehicle recharging, welcomes the opportunity to participate in the consultation regarding the **Revision of the Energy Taxation Directive (ETD).**

Iberdrola shares with the Commission the views that **energy taxation should be a tool for climate polic**y and that preserving the internal EU market requires **harmonised energy tax framework across the MSs,** as one of the keystones of the Green Deal. For this reason, Iberdrola also agrees with EC assessment concluding that current ETD does not provide a valid framework to progress toward the climate neutrality by 2050:

- The **wide range of exemptions and reductions applied by MSs** favor the consumption of fossil fuels.
- The lack of focus on carbon content of ETD does not promote **GHG emissions reductions**.
- The fragmentary implementation of theETD does not facilitate a proper **functioning of the internal market**.

A revision of the ETD could be seen as a **step towards a tax reform focusing on carbon footprint** and potentially alleviating tax burden on labor and social contributions. Finally, the revision should be **consistent with the UE-ETS** carbon pricing in place, with the **Carbon Border Adjustment Mechanism** today in discussion and more generally, with the whole framework to **protect sectors at risk of carbon leakage.**

2. Polluters pay principle

In order to transform taxation into an enabler to meet the EU decarbonisation targets, the revised ETD must incentivise the **switch to most environmentally friendly energy sources** facilitated by technology evolution, reinforcing the price **signal on carbon content** to end-users.

This implies implementing the **polluter pays principle** in the ETD, which entails that all energy sectors (electricity, coal, gas, and oil derivatives) must be subject to taxes according primarily to their carbon content. This implementation would ensure that **taxation borne** by the energy products and services is **proportional to their environmental impact**: the greater the impact, the higher the tax. **Including in addition, the energy content as** a factor to set the minimum rates could give a signal for an **efficient use** of energy supplies, consistent with the "efficiency first" principle.

In principle **all energy products should follow a consistent scheme**, avoiding as a general rule, exemptions or subsidies to fossil fuels and specific incentives for low carbon energies or technologies as well: a coherent tax framework incorporating the polluters pay principle can **reinforce and expand to other sectors the carbon pricing signal prevailing in the EU** through the ETS and trigger the replacement of carbon intensive energy by cleaner technologies. This also implies **setting the energy taxes irrespective of their use or sector**.

Hence, the review of the Directive **must consider a thorough review of current fiscal and "parafiscal" schemes** (policy charges) burdening unevenly electricity consumers vs. other energy sectors. **These charges that also act as indirect subsidies to emitting sources**. Disregarding "parafiscal" charges distorts comparisons across energy products and countries. Reverting current tax schemes not aligned with climate targets becomes even more critical as to **avoid distorting competitive advantages between energies, which since the publication of the ETD in place has significantly changed across energy vectors driven by technology** (e.g. electric transport or heating and cooling through electric heat pumps).

3. Integration of the EU market

The Commission assessment addresses that the energy taxation in place is not only unsupportive of the EU climate objectives but also a **hurdle to the proper functioning of the internal marke**t. Therefore, the ETD should make sure that any new tax, levy or charge implemented by a MS should not distort the price signal of the various energy products. **A harmonised system of energy taxation in all MSs would create a true internal energy market avoiding the distortion of competition.**

- Current framework essentially based on **minimum tax levels on their own is no longer fit for EU climate ambitions** because MSs, **using their power to modify taxes** and implement new levies and charges, tend to disturb the price signal and undermine the correct functioning of the internal market.
- **Minimum tax levels should be set at a "sufficient" level** (based primarily on carbon footprint and other externalities and the energy content as well) and **MSs should not be entitled to modify neither the tax structure nor the relative charges of the tax levels**.
- The revised ETD should li**mit the capacity of MSs to implement partial or total reductions** or exemptions to certain energy uses and sectors.
- In case the revised ETD would still be widely opened to a bespoke application of energy taxes by MS, with potential reductions and exceptions, the Commission must keep the evaluation of the coherence of each country in the implementation of the polluters pay principle. Accordingly, **MSs should be entitled to a correct implementation of energy taxes** in accordance to such principle **as a prerequisite for the approval of State Aid files in energy and environment issues**.

As above said an Energy Taxation framework becoming a tool of EU climate policy should charge energy supplies consistently based primarily on carbon content (and energy content) irrespective of the energy use or sector/industry. This includes removing current exemptions comprised in the Directive in place (agriculture, transport and industry). **A tax structure coherent with polluter pays principle should deliver incentives to boost the adoption of cleaner energies** and the investment in more efficient and decarbonising technologies.

Anyway, in order to ensure the **quick development of electric mobilit**y, supported by a swift deployment of recharging infrastructure as anticipated by the Commission's *Annual Sustainable Growth Strategy 2021*, the electricity consumption by electric vehicles should be **associated to renewable sources** and therefore, ensure the minimum tax burden corresponding to zero-carbon footprint.

Regarding electricity, its **rate shall reflect the decarbonisation of its generation mix** and its contribution of electrification, notably in mobility and H&C, to EU targets in efficiency and climate neutrality, avoiding double taxation cases and ensuring the signals on carbon footprint taxation are kept in place.

- In order to keep the path towards decarbonisation based on a more intensive electrification of EU economies, the ETD should exempt the **intermediate energy feedstock to produce electricity,** avoiding double taxation on energy vectors.

- **Regarding electricity storage facilities**, which are becoming key to fully decarbonise the electricity sector, the ETD should **avoid double taxation utility scale facilities connected to networks** (e.g. hydro pumping, batteries, etc,). The ETD should also and address efficient regimes excluding double taxation, to allow the **use of behind the meter storage facilities** (notably EV batteries) in demand side response services.
- In any case, the full burden of taxes that MSs could charge on **energy inputs for electricity generation should be supported by the principles of ETD**, essentially "polluters pay" though a tax system based on carbon footprint, and subject to a harmonised **framework, promoting a true integration of EU markets.**

4. Potential compensations

Nonetheless, the revised ETD should take into account the **effects on certain vulnerable taxpayers, either low income customers or companies** in **sector at risk of carbon leakage**. In any case, energy taxes should contribute to efficient decarbonisation signals in a consistent framework with the path to carbon neutrality. Undistorting compensation measures can be put into practice to protect especially vulnerable individual consumers and industries dealing with unlevelled playing fields in the international markets (to define compensations, rather than exemptions).

- ***Social impact on vulnerable consumers***. Given demand inelasticity to energy supplies, energy taxes could be a relatively higher burden to low-income households. **In these cases, the tax system could incorporate compensations in taxes on labor, direct subsidies or even lower VAT rates on electricity, while maintaining the climate orientation of the ETD**.
- ***Industrial sectors at risk of carbon leakage***. Energy taxation framework today in place is open to multiple exceptions and to tailored regimes by MS. Such circumstances, as addressed by the Commission assessment, are a threat for the integration of the EU market and dilute the potential (climate) signals embedded in the tax rates. Even though energy taxes could be primarily based on carbon content, the carbon footprint of these sectors is not only dependent of their energy consumption but also of their technology and their industrial processes. In this context, two important considerations to keep in mind:
    - The elaboration of country/sector rates on electricity should consider the **effective "scope 2" emissions reporting** (associated to electricity consumption) **for sectors/companies subject to EU-ETS**.
    - Sectors at risk of carbon leakage should be compensated in accordance to the **carbon leakage framework in order to avoid exacerbating imbalances in an unlevelled market playing field**.