

EU 'FIT FOR 55'

## Proposal to Recast the Energy Taxation Directive



The European Union (EU) is in the process of “greening” its entire rulebook. This will affect various economic sectors along the entire value chain, including a wide range of goods and services – domestic and imported – sold in the EU. It may also set a precedent for other countries’ climate actions.

The European Commission’s ‘Fit for 55’ package encompasses a wide range of proposals aimed at reducing EU greenhouse gas (GHG) emissions by 55% by 2030 and achieving climate neutrality by 2050.

Sidley’s dedicated team is closely following the unfolding green initiatives to help clients maximize the opportunities and overcome the challenges the EU’s regulatory changes present.

This Note concerns the European Commission’s (Commission) [proposal](#) to revise the [Energy Taxation Directive](#) (ETD).<sup>1</sup> The ETD lays down structures and minimum rates for taxation of energy products that are used as motor fuel or heating fuel and electricity. The proposed amendments cover the entire scope of energy products subject to the ETD. The proposal links, for the first time, taxation levels to the energy content and environmental performance of an energy product, thereby favoring the use of renewable fuels over conventional fossil fuels.

The ETD proposal complements the proposal for revising the EU [Emissions Trading System \(EU ETS\)](#), which introduces emissions trading for buildings and road transport.

The proposal is subject to discussion, change, and approval by the European Parliament and the Council of the EU. Affected industries and countries should consider providing input in the legislative process and start preparing for the potential impact of the proposal.

**KEY TAKEAWAY:** The proposed revisions to the ETD seek to ensure that fossil fuels are subject to *higher* minimum tax rates, while renewable energies (including biofuels, synthetic fuels, and hydrogen) are subject to *lower* minimum tax rates. Taxation would be determined by energy content (rather than volume) and by environmental performance.

## **Objectives**

The Commission considers energy taxation to be a key element in achieving the EU's climate goals, because energy products are a key source of GHG emissions. Taxation of such products alters price signals, thereby providing economic incentives for a more sustainable energy production and consumption that reduces emissions. To that end, the taxation of energy products, and in the ETD context of motor and heating fuels and electricity, needs to be tailored to the environmental impact of such products.

The Commission considers the current ETD to be insufficiently tailored to climate and energy efficiency objectives: the ETD does not provide sufficient incentives for investments in clean energy technologies; it contains a wide range of tax exemptions or reductions for particular uses, which in practice favor the use of fossil fuels; and, conversely, it disadvantages biofuels due to the taxation based on volume (rates expressed by liter), as biofuels have typically lower energy content by liter, compared to the competing fossil fuel.<sup>2</sup>

To align energy taxation with climate objectives, the proposal replaces the current, volume-based approach to setting minimum energy taxation levels for motor and heating fuels, and electricity, with one based on the energy content and environmental impact of the energy products. Energy taxation would be based on the net calorific value of the energy products and electricity.<sup>3</sup> The proposal removes disadvantages for clean technologies and introduces higher levels of taxation for inefficient and polluting fossil fuels.

The proposed changes complement carbon pricing through emissions trading, ensuring the taxation of motor and heating fuels better reflects their environmental and health impact.<sup>4</sup>

In light of several prior amendments of the ETD, and the degree of changes proposed, the Commission proposes a recast of the ETD, rather than a mere amendment.

## **Impact**

The proposed amendments impact a broad range of economic sectors, because they affect all users of motor and heating fuels, and electricity – from industry to private users, as well as air and waterborne navigation. The Commission anticipates a loss of employment of 0.2%, and increased consumer prices.<sup>5</sup> In recognition of the profound impact of the reforms, the Commission's proposal would enable Member States to provide a 10-year transition period for certain changes, including for air navigation.

With respect to consumers, and in particular low-income households that may be affected disproportionately by higher heating-related fossil fuel costs, the Commission suggests that Member States could return the additional tax revenues to consumers through lump-sum transfers. The additional tax revenues could also be used to finance investments in low-carbon and energy-efficient goods and appliances.

## **Changes Introduced by the Proposal**

The proposal envisages three main amendments: amendments that implicate a new tax rate and taxable base structure; those that ensure the removal of dated tax reductions or exemptions (which were in practice promoting fossil fuels); and those that introduce new reductions/exemptions for the promotion of clean technologies.

### **1. New Tax Rate Structure and Taxable Base**

- The scope applies principally to motor fuel, heating fuel, and electricity. It does not apply to energy products used for purposes other than as motor fuels or as heating fuels, nor to the dual use of energy products.<sup>6</sup>

- The proposal introduces a new carve-out. It exempts from taxation input energy products and input electricity which are used to produce electricity; Member States could still impose taxation to such products for reasons of environmental policy, however, without the need to respect the minimum levels laid down in the amended ETD rules.<sup>7</sup>
- Member States would continue to apply minimum levels of taxation, as revised by the proposal. These would be set, not on the basis of volume, as in the current ETD, but based on the energy content and environmental performance. The proposal also sets out different options to establishing those minimum rates. The minimum rates would be annually adjusted to take into account the evolution of their real value, so as to preserve the current level of rate harmonization (based on Eurostat harmonized index of consumer prices).<sup>8</sup>
- Similarly, with respect to mixtures of one or more products, such as E10 gasoline (gasoline containing ethyl alcohol at maximum 10%), the taxation of the mixture would newly be determined based on the energy content and environmental impact of each of the components, instead of the mixture as a whole.<sup>9</sup>

## 2. The Removal of Outdated Exemptions

- The ETD would remove exemptions for energy products and electricity for intra-EU air navigation and waterborne navigation, including fishing. The removal of the exemptions is subject to requirements under international obligations (such as aviation-related agreements).<sup>10</sup>
  - **Air navigation:** The minimum taxation levels for energy products and electricity used for intra-EU air navigation (other than business and pleasure aviation)<sup>11</sup> would gradually increase over a transitional period of 10 years. Over the same period, a minimum tax rate of zero would apply to sustainable alternative fuels (including sustainable biofuels and biogas, low-carbon fuels, advanced sustainable biofuels and biogas, and renewable fuels of non-biological origin) and electricity.<sup>12</sup> No minimum taxation levels apply for intra-EU air navigation of cargo-only flights.<sup>13</sup>
  - **Waterborne navigation:** Minimum levels of taxation are required for energy products and electricity used for intra-EU maritime and inland waterways regular service navigation, fishing, and freight transport.<sup>14</sup> These minimum levels of taxation are lower than the minimum levels for general motor fuel use.<sup>15</sup> A zero minimum rate would apply to sustainable alternative fuels and electricity over a transitional period of 10 years.
- For extra-EU air and waterborne navigation, including fishing, Member States may apply exemptions or apply the same tax levels as for these respective intra-EU activities.<sup>16</sup>

## 3. Tax Reductions/Exemptions and Promotion of Clean Technologies

- Member States would be able to apply tax reductions/exemptions for:
  - Electricity from renewable sources;
  - Electricity produced from combined environmentally friendly heat and power generation;
  - Renewable fuels of non-biological origin, advanced sustainable biofuels, bioliquids, biogas, and advanced sustainable products (CN codes 4401 and 4402).<sup>17</sup>

- Member States would be able to apply tax reductions or exemptions for the following (single) uses:
  - Energy products and electricity used for the carriage of goods and passengers by rail, metro, tram, and trolley bus, and for local public passenger transport, waste collection, armed forces, public administration, disabled people, and ambulances;
  - Energy products used as heating fuel and electricity if used by households or charitable organizations (start from zero and increase over a transitional period of 10 years by one-tenth of the final minimum rates in each year; vulnerable households might be exempt for a maximum period of 10 years).<sup>18</sup>
- A derogation could be applied for the tax treatment of electricity directly supplied to vessels at berth in a port (shore-side electricity – SSE), as it might be a cleaner alternative to the production of electricity on board. Similar treatment would be available for electricity supplied to stationary aircraft.<sup>19</sup>

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<sup>1</sup> Directive 2003/96/EC of October 27, 2003 restructuring the Community framework for the taxation of energy products and electricity, as amended, [OJ L 283, 31.10.2003, p. 51](#).

<sup>2</sup> Explanatory Memorandum of the Revision of the Energy Tax Directive (COM (2021) 562 final), pp. 1-2.

<sup>3</sup> Article 1. Net calorific values are based on Annex IV to Directive 2012/27/EU. In the case of products derived from biomass, the reference values shall be those set out in Annex III to Directive (EU) 2018/2001.

<sup>4</sup> Explanatory Memorandum of the Revision of the Energy Tax Directive, p. 2.

<sup>5</sup> SWD (2021) 642 final, p. 3.

<sup>6</sup> Article 3 of the proposal.

<sup>7</sup> Article 13 of the proposal.

<sup>8</sup> Article 5 of the proposal. Annex I contains the tables with the minimum levels of taxation applicable when mentioned by other relevant provisions of the Directive.

<sup>9</sup> Article 2(6) of the proposal.

<sup>10</sup> Articles 14 and 15 of the proposal.

<sup>11</sup> Energy products and electricity used for intra-EU business aviation and pleasure flights would be subject to the standard levels of taxation applicable to motor fuels and electricity in the Member States.

<sup>12</sup> Recital 22 of the proposal.

<sup>13</sup> Article 14 of the proposal.

<sup>14</sup> Article 15 of the proposal.

<sup>15</sup> Recital 23 of the proposal.

<sup>16</sup> Recital 24, Articles 14 and 15 of the proposal.

<sup>17</sup> Article 16 of the proposal.

<sup>18</sup> Article 17 of the proposal.

<sup>19</sup> Articles 14 and 15 of the proposal.