State aid: key elements for the agreement in the Council on energy taxation

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In October 2003, after six years of negotiation, the Council adopted the future energy tax directive (1). A key element for creating unanimity was the manner under which State aid policy has been taken into account in drafting the directive.

The concerns of the Member States

The Council, in particular through the Ecofin and Environment Councils, had pointed out on several occasions that State aid legislation might prevent any agreement on energy taxation (2). Member States shared two main concerns.

First, they felt that they would not be allowed by the Commission to support in the long run some energy products, like renewables, which are regarded as a priority in environmental and energy policies, both at national and Community levels.

Secondly, Member States felt too strongly restricted in granting long lasting tax exemptions or reductions, notably in favour of energy-intensive sectors, which are especially exposed to international competition.

While the Commission of course welcomes the development of renewable energy sources and the introduction of energy taxation from an environmental point of view, it has at the same time to ensure that, insofar as these measures involve State aid, they do not lead to distortions of competition which would be contrary to the common interest. This might be the case e.g. if producers of green electricity were overcompensated over their extra costs to the detriment of other electricity producers or if tax exemptions from energy taxes favoured certain users without giving an incentive to them to improve their environmental performance. Given the kind of business and its market structure, such distortions could be very damaging and could hinder the achievement of the single market and its benefits for the consumers.

Information actions

Some Member States’ concerns, in particular regarding control of state aid to renewable energy sources, stemmed from a lack of information rather than being a problem of substance.

The Commission explained in detail the meaning and practice of its State aid policy as applied to taxation. Under the Belgian Presidency (July – December 2001), several meetings of the Ecofin working party on taxation, in which DG Competition and DG Taxation and Customs Union took part together, were dedicated to State aid issues. The current environmental guidelines (3) were described at length; the respective purposes of Articles 87-88 (State aid) and Article 93 (tax harmonisation) were explained.

Under the Danish Presidency (July – December 2002), the Commission issued a Staff working paper on the “State-aid aspects in the proposal for a Council directive on energy taxation” (4). One conclusion here was that greater harmonisation of structures and rates of excise duty would facilitate the application of State aid rules.

The information provided has been sufficient to reassure Member States that tax support in favour of renewables would not be restrained because of State aid rules. On the contrary, it has appeared that an appropriate framework is now available

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(2) For instance, the draft political compromise prepared by the German Presidency in 1999 noted that ‘it will be crucial for Member States to evaluate the limits resulting from Community state aid rules for national provisions for reduced rates or exemptions for certain sectors and to be allowed to make use of the resulting freedom of manoeuvre in a flexible way; this applies particularly when, for environmental and/or health policy reasons, Member States wish to go beyond a Community minimum taxation. The Council considers that there is an urgent need to solve the existing problems as to the interpretation and application of Community state aid rules; it invites the Commission to contribute to this solution and to publish a clarifying communication on this subject.’ (Council doc 7738/99 Fisc 101 of 5.5.1999).

(3) Community guidelines on State aid for environmental protection (OJ C 37, 3.2.2001, p. 3).

thanks to the environmental guidelines, which gives due consideration to the needs of renewables in dedicated approaches.

For energy intensive users, it was explained that the Commission has always assessed tax exemption from energy taxes in a constructive spirit. The Commission had approved a number of exemptions and reductions from energy taxes under the Community guidelines for environmental protection 1994\(^{1}\) and introduced provisions in the current Community guidelines for environmental protection allowing tax exemptions up to ten years. The Commission assessed such tax exemptions favourably, not least taking into account the market distortions due to energy taxes not yet being harmonised.

**The nature and the logic of the Community energy tax system**

In addition to information, innovative solutions have appeared necessary to tackle Member States concerns, relating to some energy intensive processes. These solutions, accepted by the Council, are based on a comprehensive assessment of the nature and the logic of the Community energy tax system.

The Commission has had a long standing approach in which energy products should essentially be subject to a Community framework when used as heating fuel or motor fuel. This is the case in the present Council directives applicable to excise duties on mineral oils, whereby indirect taxation (except for VAT) is prohibited for mineral oils used for purposes other than as motor fuels or as heating fuels\(^{2}\).

This approach remains valid for the energy tax directive\(^{3}\). In its Article 13(1)(a), the original proposal of the Commission sets out that Member States shall exempt energy products used principally for the purposes of chemical reduction, and in metallurgical and electrolytic processes.

The Council did not however succeed in unanimously agreeing on such measures. Some Member States were willing to tax sectors involved in metallurgical and/or mineralogical processes\(^{4}\) for instance, while other Member States were in favour of granting full tax exemptions.

While a mandatory exemption would have raised no State aid issue\(^{5}\), an optional special tax treatment of certain uses of energy products can indeed constitute a favourable tax treatment, which gives an economic advantage to a specific sector. It may distort competition, and affect trade between Member States. At first sight, being imputable to the Member State, such facultative measure would constitute State aid.

Member States have however considered that energy tax must concentrate on motor fuels and heating fuels.

Therefore, the Council and the Commission considered that *it is in the nature and the logic of the new tax system to exclude from the scope of the directive other uses than as motor fuels or as heating fuels*\(^{6}\).

**The relevant uses of energy products and electricity**

Article 2(4)(b) of the Directive explains what these other uses are.

Several manufacturing processes actually use a large part of energy products for purposes other than for motor and heating fuel, e.g. as feedstock (non fuel use) or for dual uses.

In the so-called ‘dual use’ processes\(^{7}\), the energy product is used primarily for purposes outside the scope of the directive, but partly also produces heat and would thus in principle be taxable. However, in the technical reality of a ‘dual use’ process, the two uses of the energy product can hardly be distinguished and quantities of the product cannot readily be apportioned to each use.

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\(^{1}\) OJ C 72, 10.3.1994, p. 3.


\(^{4}\) The sectors concerned are among others the glass, cement, lime and steel industries.

\(^{5}\) According to the jurisprudence of the Court of Justice, for a measure to be capable of being classified as State aid within the meaning of Article 87(1) EC, it must be imputable to the State (for instance, judgement of the Court, case C 482/99, France vs. Commission, 16.05.2002). If a tax exemption stems from a Directive and must be applied by all Member States without leaving any room for discretionary application, the measure concerned is not imputable to the State. As such, it is not a State aid and does not have to be notified to the Commission pursuant to Article 88(3).


\(^{7}\) The energy tax Directives sets that ‘an energy product has a dual use when it is used both for heating fuel and for purposes other than as motor fuel and heating fuel. The use of energy products for chemical reduction and in electrolytic and metallurgical processes shall be regarded as dual use.’ (Article 2(4)(b) second indent).
Energy products used for dual-use purposes should therefore be treated the same way as energy products for non-fuel use. It also appeared important that the tax treatment of different industrial processes, manufacturing identical products, should be as similar as possible, taking into account the environmental merits of each process.

After further examination of technical and political natures, in addition to non-fuel and dual uses, mineralogical processes have also been considered as a use other than as motor or heating fuels.

To avoid distortion of competition, electricity used in similar uses and processes should be treated on an equal footing: it is therefore included in the list of Article 2(4)(b).

Finally, electricity, when accounting for more than 50% of the cost of a product, followed suit.

**Consequences for the State aid assessment**

Exceptions to the general system, or differentiations within that system, which are justified by the nature or general scheme of the tax system, do not involve State aid.

Member States may then take measures to tax, or not to tax, or to apply total or partial taxation to the uses of energy products and electricity listed in Article 2(4)(b) of the future energy tax directive, without creating a State aid in the meaning of Article 87(1) because such measures are in the nature or general scheme of the tax system.

This applies of course as long as all companies, having recourse to one of these specific uses, enjoy the same treatment in a given Member State.

The Council and the Commission have agreed to enter a corresponding statement in the Council minutes.

In transposing Article 2(4)(b), Member States have to pay attention to fair treatment of competing production processes.

**Conclusion**

The directive on the taxation of energy products is to be welcomed under different aspects. Greater harmonisation of structures and rates of excise duty improves the functioning of the internal market and reduces the risk of distortion of competition due to different taxation. By establishing higher energy tax rates than applied before in many Member States, and extending compulsory taxation to nearly all energy products, the new directive also helps to achieve environmental protection targets and enhance cost internalisation.

The legal certainty given to Member States, by means of placing some politically sensitive sectors explicitly outside the scope of the directive, has really been the key element for the unanimous agreement in the Council.

With this Directive, the Commission succeeds in accomplishing a major project in the field of tax harmonisation. The Commission also demonstrates that competition policy, and in particular state aid control, is applied to target distortions of competition without unduly restricting the design of policy measures.

Finally, it is worth noting that this article does not deepen the discussion of the relation between the provision of the environmental aid guidelines and the provisions for facultative tax exemptions for energy intensive users. This may be a relevant issue for a future article…

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\(^1\) Insofar Article 2(4)(b) takes account of specific situations as encountered by the Commission when assessing State aid C 18 and 19/2001. See footnote 10.


\(^3\) This corresponds to the assessment made by the Commission in the above mentioned State aid case C 18 and 19/2001.

\(^4\) Council document 8084/03 add 1 Fisc 59 of 3.4.2003.

\(^5\) See article 17 of the energy tax Directive. Such exemptions will in most cases constitute State aid and will have to be notified to and approved by the Commission. The Commission explained the criteria to assess the compatibility of the aid with the environmental aid guidelines at the Working Party on Tax Questions on 14 November 2002.