KPMG comments on the European Commission's Public consultation on the revision of the Energy Taxation Directive

Introduction

KPMG[1] member firms in the EU (hereafter "we") are pleased to respond to the European Commission's (EC) Public consultation on the revision of the Energy Taxation Directive (ETD) ("the Consultation"), which we consider to be a very important project.

In order to address the pressing need for environmental, social and governance issues to be addressed by business KPMG has created KPMG IMPACT, which brings together an experienced network of professionals from across the globe to deliver industry leading practices, research and solutions to address the biggest issues facing our planet*.* KPMG IMPACT aims to help our clients fulfil their purpose and deliver against the Sustainable Development Goals (SDGs) so that all of our communities can thrive and prosper. It gives KPMG a transparent and consistent voice across five propositions that address:

- ESG and Sustainability;
- Economic and Social Development;
- Sustainable Finance;
- Climate Change and Decarbonisation; and
- IMPACT Measurement, Assurance and Reporting.

Environmental taxes raise many complex and often competing issues. For these reasons we have found it not possible to answer all the questions in the Consultation without giving a partial or potentially misleading response – in particular, in Part 7 on exemptions. Instead we set out below some thoughts on carbon taxation and how the Commission could approach deciding whether or not a particular sector should be exempted.

In replying to the Consultation, we assume that the purpose of revising the ETD is to reduce carbon emissions and other greenhouse gases rather than a different objective such as increasing tax revenues and we have framed our responses accordingly.

Structure of carbon taxation and impact on the ETD

As stated above, it is our understanding that the intention of the EC is to shift the focus of the ETD from regulating energy taxation within the EU to driving carbon emissions reduction – ie making the ETD a carbon tax directive. Clearly, it is important that all carbon pricing and other measures to address carbon emissions are considered holistically so that they form a package with the consistent goal of addressing climate change and do not create multiple layers of complexity and administration or competing objectives. In particular, it is necessary to consider how the revised ETD will interact with the EU Emissions Trading Scheme (ETS) – which is currently the EU's main carbon pricing initiative. The above raises several issues, for example:

1) Is it appropriate to consider removing the exemption for industries covered by the ETS and adjusting that system so it becomes a supplementary one sitting above the main fuel duty contained in the ETD?
2) Subject to point 1 above, it follows that, in principle, the ETD should apply to all energy products and sectors; it should be based on the emissions released; and it should be set at a rate which will influence behaviour to reduce those emissions – whether by changing the energy product or process or reducing consumption.

[1] KPMG is a global organization of independent professional services firms providing Audit, Tax and Advisory services. KPMG operates in 147 countries and territories and has more than 219,000 people working in member firms around the world. Each KPMG firm is a legally distinct and separate entity and describes itself as such. This comment paper is produced on behalf of KPMG member firms located in the EU forming part of KPMG's Europe, the Middle East & Africa (EMA) region.

An example: Electricity

Currently the ETD exempts energy products used in producing electricity – but with a possibility to waive the exemption for environmental policy reasons. Electricity itself is then subject to duty while electricity from non-renewable resources is covered by the ETS. Given the expansion in technology to produce electricity from renewables since the inception of the ETD and the change in focus proposed by the revision of that Directive, would there be merit in reconsidering this approach?

Duty could be charged on energy products used to produce electricity and the use of electricity could be exempted. The ETS would continue to apply but subject to adjustments to recognise that fuel duty would be the primary carbon pricing instrument. The intention would be to encourage the production of energy from renewable resources.

Consideration would have to be given to the impact on the overall price of electricity to the end customer if the incidence of taxation was changed (ie shifting duty from the end consumer to the producer by taxing the source energy products). If the change resulted in higher prices being passed on to consumers it may be necessary to reduce the duty on the associated energy products – unless the intended policy was to increase the cost of electricity from non-renewables to the consumer[2].

Simplicity

In order to improve simplicity and create a level playing field across the European Union it is important that the rules are harmonized so that the same products or sectors are taxed or exempted in each country. However, as revenue raising remains largely a prerogative of sovereign governments, the ETD should set minimum rates but allow member states to increase them if they wish.

Which sectors or industries should be exempted?

In order to determine whether or not a particular sector should be exempt, we consider the following steps could be taken into account:

1) Can the sector reduce its greenhouse gas emissions – by, for example, changing energy product, processes or reducing consumption? If it cannot, any duty may be a deadweight cost. This may suggest the need for a reduction or exemption and/or for recycling tax revenues into incentivising research and development to
2) Will imposing tax on a sector create a competitive disadvantage for European businesses in comparison with businesses based in countries with less stringent greenhouse gases emission controls?
3) If the tax could create a competitive disadvantage could this be addressed by a carbon border adjustment mechanism (CBAM)[3]?
4) How easily could businesses circumvent the tax without reducing their emissions (for example, the maritime or airline industry could take on fuel outside the EU – which may actually increase greenhouse gases emissions if it led to reduced efficiency in voyages).

Keeping a level playing field between large business and smaller enterprises

A concern which is sometimes raised with environmental taxes is that a larger firm can afford capital investment to adopt greener technology, but smaller firms may not be able to and so would be at a disadvantage from having to pay effectively higher amounts of tax. While this concern should be taken into account in considering exemptions from duty, another (or complementary) approach would be to recycle

[2] A further option would be to keep duty on electricity produced from fossil fuels (as well as on the energy products themselves). This would create a double layer of taxation on such electricity but create an incentive for consumers (whether businesses or the public) to elect to take electricity from green sources. However, this would have to be predicated on electricity companies being able to offer a choice of green electricity to customers and consideration would be needed about how to address the situation where insufficient electricity could be produced from renewables and a supplier had to rely on fossil fuel electricity.

[3] It is noted that the EC has launched another consultation on a CBAM and it is recognised that this is a complex area and it may not be practical to apply it to certain industries or indeed at all.

tax revenues into some form of subsidy to enable smaller firms to adopt green solutions. Such subsidies would need to comply with state aid rules.

Transitional rules

Where changes to the ETD result in a tax increase there should be an adequate transition phase to allow taxpayers to adjust as appropriate.

Social impact and compensation measures

We consider the social impact and compensations measure are very important considerations. These should be handled at the member state level due to differing economic and social situations. That said, we agree there is merit in looking to move the tax burden away from labour and in implementing social welfare programmes to protect poorer members of society who would be adversely affected by any changes.

World Trade Organisation (WTO) impact

It is accepted that WTO rules allow members to impose an internal tax on energy commodities such as coal, oil and gas, and apply that same tax on like imported energy commodities.

Some specific comments

Low carbon products

We agree that the duty should take into account all externalities such as greenhouse gases emissions and other polluting emissions. For this reason, we believe there should be differentiated treatment for certain synthetic fuel and advanced bio-fuels to encourage their use to reduce carbon emissions while addressing any other externalities.

Hydrogen

We agree with the statement on page 21 that *"hydrogen will play an important role in achieving carbon neutrality"* and have therefore ticked all the boxes to agree that there should be an exemption for all uses of hydrogen. We have not ticked Question 7 which refers to restricting exemption to clean hydrogen as we consider that when it is produced from fossil fuel with full carbon capture and storage it should also be treated as "clean", not just when it is produced from electrolysis with renewable electricity.

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