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European Commission proposes Regulation providing for a solidarity contribution on surplus profits in the EU fossil sector

European Commission – Temporary solidarity contribution – Surplus profits – Energy prices – Fossil sector – Regulation– Qualifying Majority

On September 14, 2022, the European Commission issued a proposal for a Council Regulation on an emergency intervention to address high energy prices.

The proposed Regulation introduces a demand for Member States to seek to implement measures to reduce their total monthly gross electricity consumption by 10 percent compared to the average of gross electricity consumption in the corresponding months of the reference.

The proposal also provides for two instruments, which the European Commission considers to be complementary: (i) a cap on revenues of electricity producers and (ii) a solidarity contribution on surplus profits in the fossil sector compared to prior years.

The solidarity contribution is proposed as an exceptional measure based on unexpected profits of the energy sector made due to the energy crisis. Funds collected through the contribution would be used to finance relief measures for households and companies and to invest in renewable energy sources. The contribution would be levied by Member States at a rate of at least 33 percent on profits generated in 2022, which are above a 20 percent increase on the average profits generated between 2019 and 2021.

Background

The proposed Regulation is aimed at tackling the issue of rising gas and electricity prices in 2022 following the Russian invasion of Ukraine and a shortened supply caused by extreme weather conditions over the summer months, including droughts and extreme heat that have had an impact on electricity generation.

Due to the fact that such rising energy prices place high burdens on households and companies and dampen the economic recovery, several Member States have introduced various relief measures at national level. The Commission also released recommendations and guidance in Spring 2022 through its Communication on short-term market interventions and long-term improvements to the electricity market design and the

REPowerEU Plan, aiming to safeguard and secure energy supplies. As part of this plan, the Commission recommended that Member States consider the introduction of temporary windfall profits taxation regimes (for more details, please refer to E-News Issue 151) without requiring binding commitments. According to the Commission, windfall profits taxation could be an effective instrument to re-channel exceptional profits generated by energy companies due to favorable external marketing conditions (i.e. high energy prices), while generation costs have remained low for those companies.

While some Member States (including Italy and Spain) and jurisdictions outside the EU (e.g. the UK) have started introducing windfall profits taxation regimes (please see E-News Issues 156 and 159), other Member States, as well as the European Parliament, have called on the European Commission to coordinate the design of such windfall profit taxation schemes. In July 2022, the Commission noted that it was considering legal and economic aspects of a windfall profits tax at EU level and acknowledged that such a measure would need to be carefully designed to avoid undesirable market distortions. In particular, the Commission highlighted concerns about the complexity of designing and implementing windfall profit taxes in respect of the definition of extraordinary profits, timing aspects and tax rates (for more details, please refer to E-News Issue 158).

Proposal for a temporary solidarity contribution

The European Commission's proposal is in the form of a Regulation on an emergency intervention to address high energy prices. It is based on Article 122(1) of the Treaty on the Functioning of the EU (TFEU), which allows the Council to decide – based on a proposal from the European Commission, in a spirit of solidarity between Member States, on the measures appropriate to the economic situation, in particular if severe difficulties arise in the supply of certain products, notably in the area of energy.

The proposal provides for two complementary instruments in form of a cap on revenues of electricity producers and a solidarity contribution on surplus profits in the fossil sector compared to prior years. The solidarity contribution is proposed in Chapter III of the Commission's Regulation proposal and is structured into five articles that set out the rules, starting with general provisions on the scope of the measure, moving to the provisions covering the base and rate, and finishing with provisions covering the use of the contribution revenue and the application period.

Scope

The measures would apply to companies and permanent establishments that are considered to be resident in an EU Member State for tax purposes and that perform activities in the oil, gas, coal and refinery sectors, where at least 75 percent of turnover is generated in the field of the extraction, mining, refining of petroleum or manufacture of coke oven products.

Base

The base for the solidarity contribution would be calculated as the taxable profits in the fiscal year starting on or after January 1, 2022, which are above 20 percent of the average taxable profits of the three fiscal years starting on or after January 1, 2019 (surplus profits). Taxable profits would need to be determined in accordance with national tax rules. Where the average annual result is negative, the average taxable profits shall be deemed to be zero.

Rate

The contribution would be levied at a rate of at least 33 percent on surplus profits. The contribution would be levied in addition to the regular taxes and levies applicable according to the national legislation of a Member State.

Use of proceeds from the temporary solidarity contribution

Member States would be responsible for collecting the solidarity contribution and redistributing the profits by providing financial support measures to households and companies to mitigate the effects of high energy prices. The proceeds would also need to be used by Member States to help the reduction of energy consumption, support energy-intensive industries, promote investments by final customers in renewables, energy efficiency or other decarbonization technologies and cross-border projects in line with the REPowerEU objectives. In addition, Member States would be required to devote a share of the revenues to the common financing of measures.

Application period

The Regulation would apply for a period of one year from the date of its entry into force. The mandatory solidarity contribution would apply from December 31, 2022 at the latest and would only apply to surplus profits generated in the fiscal year that started on or after January 1, 2022.

The proposal further provides that Member States would be required to inform the Commission about the introduction of the temporary solidarity contribution by October 15, 2022. In addition, Member States would need to report on any subsequent amendments to the temporary solidarity contribution and on the specific use of the proceeds stemming from the solidarity contribution. By October 15, 2023, the Commission would also be required to carry out a review of the proposed solidarity contribution in respect of the surplus profits generated by the fossil fuel sector and report on the main findings to the Council.

Next steps

The legislative proposal will now be submitted to the Council for adoption. The Regulation requires a qualified majority vote in the Council to be approved.

Once the Regulation is adopted, it would enter into force on the day following that of its publication in the Official Journal of the European Union. An EU regulation is binding in its entirety and is directly applicable in all Member States. Accordingly, the Regulation would result in a swift EU-wide application of the measures without the need for transposition into national law.

ETC Comment

As several Member States have already adopted or are currently considering the adoption of windfall profit tax regimes, the explanatory memorandum to the Regulation notes that unilateral measures adopted would create uneven conditions for companies operating in the EU energy market. Accordingly, the solidarity contribution is aimed at providing a European instrument to avoid negative spillovers within the European energy market caused by uncoordinated national measures and to ensure consistency with the objectives of REPowerEU.

Nevertheless, the proposal provides the option for Member States to apply a rate higher than the minimum rate of 33 percent, to extend the scope of the contribution or to combine the new contribution with existing similar measures already introduced at national level. This could be seen as a compromise solution for Member States in order for the Regulation to be adopted by a qualifying majority in the Council.

It is understood that the Czech Presidency of the Council is considering the initiative to be a matter of priority (please refer to E-News Issue 158) and that an extraordinary Energy Council meeting has already been scheduled for September 30, 2022 to discuss the European Commission’s Regulation proposal.

Should you have any queries, please do not hesitate to contact KPMG’s EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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