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Fitness Check of the 2012 State aid modernisation package – focus on environmental tax aid measures

The State aid framework needs to be reformed so that it contributes to and does not counteract the development towards a fossil-free society and the implementation of the Paris Agreement. This includes provide better tools to Member States to combat climate change, including improving the public financing tools at a level necessary for enabling the transition of the fossil fuels based industry into more climate friendly technologies. In line with this, the framework must also contain a phasing out of aid harmful to this necessary climate transition.

We would therefore suggest to the Commission to revise the EU state aid rules with the view to enabling Member States to take the political decisions necessary to pursue climate-friendly goals, including to support new value chains and structures and new employment possibilities with a clear link to serving the purpose as a substitute for value chains no longer favorable from a climate perspective.

Sweden takes pride in being a climate leader. We are fully committed to the Paris agreement's temperature goals, the EU climate target for 2030 and we support the establishment of an ambitious Long-Term Strategy for climate action. Further, our national target is to achieve net-zero emissions in 2045. The transport sector is the only one with a specific national sub-target, stating that by 2030 emissions will be 70 per cent lower than they were in 2010.

Starting back in the 1990's, environmental taxes have ever since been cornerstones of the toolbox for Sweden to reach set energy, environment and climate policy targets. Cost-effectively designed environmental taxes

have served us very well and we have seen good results. Sweden wants to continue to lead in the future, and thus we need access to pragmatic tools, such as environmental taxes. The tax design may need to include state aid elements to ensure overall best environmental results. In this respect, properly designed provisions in the Energy and Environment Aid Guidelines (EEAG) and the General Block Exemption Regulation (GBER) are crucial. It is important that this legislation help and not risk hindering the EU Member States to reach energy, environment and climate goals.

Due to the special characteristics of environmental taxes, they merit special consideration when dealing with state aid implications that may arise from their application. In this note, the Swedish Government would like to bring forward some important aspects in this context. The aspects covered basically include:

- Why does aid relating to environmental taxes merit special considerations?
- Chapter 3.7 of the EEAG and Article 44 of the GBER
- Aid to food-based biofuels and bioliquids should not be disqualified from being granted aid
- Transparency provisions in the EEAG and the GBER
- Further clarification on the concept of state aid in relation to environmental taxes.

1. Why does aid relating to environmental taxes merit special considerations?

Market-based instruments – and in particular different kinds of environmental taxes – have over the past years continued to play an increasingly important part of the tool-box Member States are using to reach set climate and energy targets in a cost-effective way. Further, the need to ensure additional revenues has also led many Member States to decide on increased tax levels. All this has put a strain on the EU's state aid framework. As the Commission has stated in its public consultation on "the Fitness Check" one aim of this check is to take into account current and already known future challenges. One important area is the climate issue. The EU and its Member States have signed up to the Paris agreement. The challenge

of reducing emissions at a sufficient pace as to limit global warming to 1,5 degrees is daunting. Climate change is an existential threat to our civilisation and EU policies and regulations must facilitate and not impede the phasing out of fossil fuels.

When considering environmental tax policy design, there are many political objectives that interact. This goes for the EU-level as well as nationally. The rationale for using market based instruments, such as environmental taxes, lies in that they stimulate that cost-effective measures are undertaken by making it profitable for those firms (or individuals) to act as long as benefits are higher than costs. Member States may want to be more ambitious in certain policy areas compared to the objectives set up at the EU-level and it is important that state aid can be used to make it possible for Member States to be more ambitious than the common objectives. The EU framework needs to provide a certain amount of flexibility, to provide an opportunity for Member States to examine different ways and tools for reaching set goals. The application of the state aid rules by way of the EEAG or under the GBER is a crucial aspect in this context and should be helping Member States to design environmental tax systems, which will contribute to achieve various objectives by way of a sustainable development and economic growth, as set out in different EU strategies.

There is a great need to secure a robust, yet effective state aid framework, that ensures sufficient legal certainty for the beneficiaries concerned, while at the same time being flexible enough to take account of the need of Member States to rapidly be able to decide necessary aid measures.

It goes without saying the Swedish Government certainly supports the Commission's overall state aid approach that distortion of competition should be avoided and that the Treaty rules on state aid should be upheld. Further, it is of great importance to the EU as a whole to maintain a free and fair competition, which also indicates that state aid should be kept at a reasonably low level. Another key priority for the EU is simplification and reducing the administrative burden. There is always a need to strike a balance – are extra administrative burdens put on individual enterprises justified, compared to the potential risk of distortions on the internal market that could occur if the relevant state aid assessing body would not have access to detailed data?

Environmental taxes differ fundamentally in many ways from that of other taxes, such as income, capital or corporate taxes and VAT.

The tax base is different by nature. Special tax exemptions and reductions made in order to secure an effective fulfilment of particular environmental objectives, which might look odd if applied in other tax systems, can be fully logical from an environmental tax point of view. After all, the very aim of an environmental tax is to serve as an incentive for enterprises to change their behaviour in line with the established aim of the tax. Environmental taxes can also be employed to prevent sub-optimal market outcomes, from the society's point of view, by internalising the market failure they target (e.g., an externality). Thus, by getting the market prices right, environmental taxes are used to prevent market distortions from occurring. A differentiated tax can in that sense be a guarantor of a level playing field rather than a distortion to the market.

Further, tax measures are often generally open for application by a large number of economic operators, based on specific legislation decided by national parliaments. The tax authorities in general simply administrates the collection of the tax from the tax payers and ensures, by checking tax declarations and doing regular audits, that the tax payers are following the legal provisions of tax rate and deductions. There is no room for any discretionary measures. This is also something that makes taxes different from other forms of aid, where sometimes an individual assessment of applications from the beneficiaries are part of the procedures.

2. Chapter 3.7 of the EEAG and Article 44 of the GBER – aid in the form of reductions or exemptions from environmental taxes

2.1 Points 167-175 of the EEAG and Article 44 of the GBER works well – *tax paid above EU minimum tax levels*

During the deliberations of the 2008 Aid Guidelines, the Swedish Government expressed concern about the design of the guidelines in relation to its effects on aid within the area of environmental taxation. We were pleased that the Commission took many of our concerns into consideration. In our view the introduction of a specific chapter dealing with environmental taxes in the 2008 Guidelines, and in particular the corresponding provisions in the GBER, constituted a major improvement.

These provisions were, basically unchanged, transformed into the current EEAG and GBER in 2014.

The Swedish Government would like to emphasise the need to maintain the provisions in Points 167 – 175 and the corresponding provisions in Article 44 in combination with Article 6.5 e of the GBER for aid in the form of tax reductions and exemptions from taxation according to Council Directive 2003/96/EC (Energy Taxation Directive). This method has shown that it is possible to strike a reasonable balance between the administrative burden and the necessary state aid control. Using the GBER, Member States can go through with desired tax decisions in this area without delay, in a way that still gives the economic operators a reasonable measure of legal certainty. Further, the GBER system in our view contains sufficient rules to ensure that a reasonable state aid control can be maintained.

2.2 It is important to maintain the provision of 'indirect incentive effect'

When it comes to point 168 of the EEAG, it is crucial for enabling a good design of environmental taxes in the future to maintain the reference to the concept of 'indirect incentive effect'. This provision relates to the situation, being relevant in for example a couple of Swedish state aid cases, namely that a Member State applies a two-level tax system for energy products and electricity used by different sectors of the society and that the lower tax level is the prerequisite for the high tax level. Thus, according to Commission state aid decisions, aid is considered to be given to the low-taxed enterprises resulting in an indirect improvement of the level of environmental protection. The improvement is indirect, as the improvement is achieved by the enterprises being subject to the higher tax rate. This higher tax rate was made possible by the introduction of aid in the form of the lower rate for certain other enterprises. This is a common concept when designing a well-functioning environmental tax policy and needs to be maintained.

2.3 Chapter 3.7 of the EEAG and Article 44 of the GBER ought to be used also for environmental tax aid to biofuels and bioliquids

The Commission upholds the principle to use Chapter 3.3 Aid to energy from renewable sources also when assessing aid cases regarding aid to biofuels and bioliquids in the form of reductions in environmental taxes under Directive 2003/96/EC. The Swedish Government fails to see the logic in such an application and believes it would be appropriate to base a

state aid assessment on Chapter 3.7 rather than Chapter 3.3 of the EEAG, if the minimum tax levels of Directive 2003/96/EC are observed. An over-compensation assessment by the state aid rules would in such a situation not be necessary, as the criteria of necessity and proportionality are already handled by need to fulfil the EU minimum tax levels and the other provisions of chapter 3.7 of the EEAG. As Article 16 of Directive 2003/96/EC lays down conditions for granting tax reductions to biofuels and bioliquids, also GBER ought to be applicable to environmental tax aid to biofuels and bioliquids.

2.4 Points 176 – 180 of the EEAG – non-harmonised environmental taxes or taxation below EU minimum tax levels

Points 176 – 180 of the EEAG handle aid in the form of reductions of or exemptions from non-harmonised environmental taxes. They also cover situations where the tax paid, after the deduction of aid, does not respect the minimum tax levels set out in the Energy Taxation Directive. The present design of the provisions was introduced in the 2008 Aid Guidelines and the provisions were to a large extent transposed into the EEAG in 2014.

It is fair to say that the conditions set out, in order to prove that the aid is necessary and proportional, are hard – if not even in some cases close to impossible – to meet. Proving the conditions in any case result in an excessive administrative burden; this is not reasonable. Further, the provisions primarily seem designed with a view to aid granted to manufacturing industry enterprises in the form of tax reductions of energy taxes, not taking proper account of the fact that non-harmonised taxes can be levied on other kinds of tax bases that may require more case-specific conditions.

It is true that it may a somewhat complicated task to design state aid provisions for non-harmonised taxes. Nevertheless, we need to bear in mind that taxes in yet not harmonised areas may form an important part of Member States' tool-box to meet set policy objectives. The EEAG should not penalize such taxes, but strive for a logical and coherent treatment of aid measures also regarding such taxes.

In particular, we would like to comment on one of the requirements to be met for an aid to considered proportionate, namely point 178 a), that an enterprise has to pay at least 20 % of the national tax. In our view, the strict

wording of this provision risks effectively hindering a Member State from introducing a high general tax level that would contribute to a significant overall improvement in the level of environmental protection. In terms of internalising external effects and level the playing field it could possibly also lead to a higher tax level then the external costs associated with the activity. The 20 % rule determines and risks limiting the environmental effect of the tax and we fail to see the reason for that.

One way could be to introduce a "rule of reason clause" as a complement to the 20 % rule, enabling the Commission to be able to accept a lower level than 20 % of the national tax in certain specific situations. This could for example relate to a Member State applying a high tax level in an area of great importance to an environment strategy and that a well-defined exemption from the tax is deemed necessary to reach an overall considerable improvement in the level of environmental protection.

3. Aid to food-based biofuels and bioliquids should not be disqualified from being granted aid

The EEAG establish that operating aid to food-based biofuels can only be granted until 2020. We note that in the proposed prolongation published by the Commission for public consultation, the "end-date" for state aid to food-based biofuels remains 2020.

Sweden has the highest share of renewable energy in the transport sector in the EU. In this context, state aid has been critical. Most vehicles sold today are combustion-vehicles and will still be used in 2030. While electrification, investments in batteries and battery technology, as well as more efficient transports are crucial, biofuels will still have to make a significant contribution to reduced emissions as well.

The newly updated Renewable Energy Directive does not ban food-based biofuels, bioliquids and biomass fuels. These fuels are contributing to reach climate target both within and outside the EU ETS. We cannot afford to disqualify a significant portion of the available biofuels that have been deemed sustainable in accordance with harmonized EU-legislation. They can and should contribute to our common achievement of the Paris agreement's temperature goals, the EU target to 2030, and long-term ambitions.

The Swedish Government thus sees no reason to uphold the 2020 time limit in the EEAG and believes that the end-date should be pushed forward until at least 2030.

4. Transparency provisions in the EEAG and the GBER – points 104-106 of the EEAG and Articles 9 and 12 of the GBER

The issue of tax confidentiality was a matter of great concern to Sweden, as well as to many other countries, during the discussions prior to the Commission's decisions on the EEAG and the GBER in 2014. The Swedish Government was grateful for the Commission's acknowledgement of those concerns by way of stating that publishing individual tax aid amounts would not be provided in exact figures but in certain defined ranges. The same reasons that were brought forward in the discussions prior to the 2014 decisions are valid today and the Swedish Government finds it essential that the principle of publishing tax aid amounts in ranges is maintained also in the post 2022 guidelines and GBER. In connection to this we would also point out the need to maintain the special provision relating to the monitoring of fiscal aid found in the version of Article 12 of the GBER by the amendment Commission Regulation 2017/1084 of the 2014 GBER.

5. Further clarification of the concept of state aid

As mentioned earlier, state aid issues are of paramount importance when considering the design of environmental tax schemes. It is hard to reconcile the innate conflict between the freedom of Member States to design the taxes to influence the behaviour of enterprises through tax incentives/disincentives, but at the same time not 'favouring certain undertakings or the production of certain goods'. It would be of help for Member States if the Commission, within the current state aid fitness check revision, could provide some guidance on this difficult question regarding the actual concept of state aid.

The Swedish Government acknowledges that it is challenging to draw general conclusions from the ECJ's case-law in this regard. We would nevertheless appreciate if the Commission would elaborate on the below underlined concepts.

5.1 Nature and logic of environmental taxes

The EU state aid rules should not apply to taxation which makes a difference between enterprises, if such a differentiation is selective due to the fact that it arises from the nature or the overall structure of the system of which they form part (Case C-487/06 P British Aggregates Association v Commission compared with the more recent Spanish cases regarding Catalonia, case C-233/16, Asturias, cases C-234/16 and C-235/16 and Aragon, cases C-236/16 and C-237/16). Following this logic, the Swedish Government believes that a taxation design which is consistent with the environmental objectives of the tax scheme should not be considered to constitute state aid. In our view, the Commission's earlier notice on the application of state aid rules to measures relating to direct taxation does not provide Member States with enough guidance regarding the nature and logic of environmental taxes.

5.2 Selectivity

The selectivity criterion is of specific importance when assessing environmental tax aid. In order for a differentiation in taxation to be considered a selective advantage, the scope of the tax must be inconsistent with the objectives related to the environmental protection pursued (General Court's Judgement 7 March 2012 after referral of the abovementioned case, T-210/02 RENV, paragraph 70). In other words, products with comparable environmental impact in light of the environmental objective should be taxed equally. The notion of state aid related to equal taxation should be assessed on the basis of the effects of the taxation. A clear example of inconsistent taxation can be found in the case now discussed. Competing products (aggregates: a form of rocks) that had a similar environmental impact in light of the objective pursued, were taxed differently (paragraphs 71-75).

The determination of the reference framework has a particular importance in the case of tax measures, since the very existence of an advantage may be established only when compared with 'normal' taxation (Case C-88/03 Portugal v Commission, paragraph 56). On the other hand, advantages resulting from a general measure applicable without distinction to all economic operators do not constitute state aid within the meaning of Article 107 (1) TFEU (Case C 156/98 Germany v Commission, paragraph 22, and Joined Cases C 393/04 and C 41/05 Air Liquide Industries v Belgium, paragraph 32 with further references).

A differentiation in taxation is only selective if, within the context of a specific legal system, that measure constitutes an advantage for certain enterprises in comparison with others which are in a comparable legal and factual situation in light of the objective pursued by the measure in question (Portugal v Commission, paragraph 56 and C-143/99, Adria-Wien Pipeline, paragraph 41). Similar things should be treated the same while objectively different things should be treated differently (C-279/93, Schumacker, paragraph 30). It seems consistent with this case-law that a lessened tax burden given to all enterprises in a comparable legal and factual situation should be considered a general measure. It would be helpful if the Commission could elaborate and give examples of situations when enterprises would be considered to be in the same factual and legal situation and situations when this would not be the case. The recent ECJ case law regarding the Spanish cases merit special consideration in this respect.

5.3 Normal taxation

The meaning of the term "normal taxation" would benefit from a more in-depth discussion by the Commission. The actual aid intensity for a specific tax aid scheme is determined by a reference to the amount of taxation that would have been applied if no aid had been given. Let us take an example and assume that Member State A is applying a general energy taxation rate on coal of 300 euro per ton. A lower level of 100 euro per ton coal is applied if the coal is consumed by industrial enterprises. These industrial enterprises could be considered to be receiving an aid amounting to 200 euro per ton coal. However, this aid amount may be seen as a fictive amount as Member State A would not be in a position to apply 300 euro per ton coal for industrial consumers due to the apparent risk of carbon leakage. This would be even more striking if we consider that an EU minimum tax level might have been laid down at 5 euro per ton coal. The Swedish Government thus believes that the interpretation of the EU state aid rules would merit from a more flexible approach when it comes to deciding on the aid intensity. In particular, this relates to Member States applying internationally high rates of environmental taxes.

In the modern and global economy, certain EU-based enterprises are competing on a market where their only competitors are found in countries outside the EU. In this situation, it can certainly be argued that the factual situation at stake for such an enterprise – for example in the mining sector - is not the way energy is taxed nationally when used by other enterprises, for

example the local bakery or grocery store, but rather how it is taxed when used by the mining enterprise's major competitors around the globe.