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The Limits Imposed by Union Law on the Design of Fiscal Instruments Intended to Protect the Environment

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ABSTRACT

Since the Treaty of Rome, the protection of local producers by Member States is, in principle, prohibited. Indeed, the Court of Justice of the European Union has, throughout the decades, done its utmost to ensure that the Treaty provisions on the free movement of goods and services serve the goal of greater European integration. While reading these judgments, it is very easy to overlook the fact that taxation was at their core. Indeed, throughout the 1960s and 1970s, numerous taxes on imports and exports became the object of the Court's most foundational cases, and current legal literature still praises their unifying effect. Seventy years later, Europe, like the rest of the world, must face up to two unprecedented global crises: the collapse of biodiversity on the one hand, and climate change on the other.

The recent alarming reports regarding climate change and biodiversity loss mean that, from now onwards, the Union and its Member States must deploy all measures conceivable to reach the objectives set out in international agreements such as the Paris Agreement on Climate Change, the Glasgow Climate Pact and the latest Kunming-Montreal Global Biodiversity Framework. The object of this paper is to analyze which fiscal measures Member States and the Union may adopt to prevent further damage from being done to the environment. Damage which some would say has been primarily caused by failures in the market which the Court of Justice set out to create during the first two decades following the Union's inception. In this context, the author identifies all the legal constraints which Union law imposes on the design of environmental taxes at national level, together with the constraints which primary law places upon the potential conception of a European-wide environmental tax.

The paper opens with a general discussion of the theoretical foundations of environmental taxes. It demonstrates that there exists, at least in theory, an elementary understanding of the essential functions which environmental taxes should possess. It then goes on to discuss the avenues open at the European level for the institutions to act in the fiscal field by adopting Europe-wide environmental taxes. Although the Union seems badly equipped to introduce a general tax on activities which are environmentally harmful, its efforts in matters of indirect taxation merit both praise and critical discussion. In the second part of the paper, the author discusses the principal provisions of Union law which guide Member States in their adoption of environmental taxes.

Finally, the author demonstrates that the actual state of Union law does, indeed, permit the utilization of environmental taxes to shift economic demand in favor of environmentally friendly goods. Although Member States continue to enjoy a large margin of appreciation in the field of taxation, the author still believes that a more comprehensive response to the current environmental crisis should ideally originate from the institutions - even if part of it means creating a European-wide environmental tax.

KEYWORDS

Environmental Taxation; Internal Market; Ecotaxes; State Aid; Circular Economy

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INTRODUCTION

By ratifying the Paris Agreement of 2015, the European Union has set itself the goal of becoming carbon neutral by 2050.[1] Under the guidance of the von der Leyen Commission, all legislative and administrative measures of the Union and its Member States must aim to respect the 1.5°C threshold on global temperatures envisaged in the Agreement. In a 2018 Communication, the Commission notes two things on the role that taxation ought to play in the fight against climate change. First, taxation is one of the most effective tools to implement this strategy, and secondly, taxes should be applied with the aim of offsetting negative environmental impacts and satisfying demand for more efficient and less polluting energy technology.[2] Four years before that, the Institute for European Environmental Policy observed an ever-increasing use of environmental taxes in Europe, and it appears that this trend is set to continue.[3]

Unfortunately, the climate crisis has also been accompanied by enormous rates of biodiversity-loss globally. This situation has been dubbed a global "double emergency" by the World Wildlife Fund [hereinafter W.W.F.] which states, in its most recent flagship report, that climate change is also a significant cause of biodiversity loss.[4] The W.W.F. reports that wildlife populations have plunged by an average of sixty-nine percent between 1970 and 2018.[5] Similarly, the Food and Agriculture Organization [hereinafter F.A.O.] reported in 2020 that an estimated 420 million hectares of forest have been lost through deforestation since 1990 (a territory approximately the size of Libya).[6] This dramatic state of affairs has led to the adoption of the Kunming-Montreal Global Biodiversity Framework which, while being hailed as a "Paris Biodiversity Agreement", has set out a widely publicised "30 by 30" nature conservation and restoration goal (i.e., to bring the loss of areas of high biodiversity importance close to zero by 2030, to restore thirty percent of degraded land and sea ecosystems globally by 2030, and to conserve and manage thirty percent of terrestrial, inland water, and coastal and marine areas by

[1] *See Climate Action and the Green Deal, European Commission* (Sept. 18, 2022), https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/climate-action-and-green-deal_en.

[2] *See Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, A Clean Planet for all A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy,* COM (2018) 773 final (Nov. 28, 2018).

[3] *See Final report of the Institute for the European Environmental Policy (IEEP) on the "Environmental tax reform in Europe: Opportunities for the future"*, (May 30, 2014), https://ieep.eu/wp-content/uploads/2022/12/ETR_in_Europe_-_Final_report_of_IEEP_study_-_30_May_2014.pdf

[4] *See* WWF, *Living Planet Report 2022 Building a Nature-Positive Society*, 16 (Oct. 13, 2022), https://wwfint.awsassets.panda.org/downloads/embargo_13_10_2022_lpr_2022_full_report_single_page_1.pdf.

[5] *See id.* at 32.

[6] *See* FAO, Main Report of the Global Forest Resources Assessment 2020, at 18 (Nov. 12, 2020).

2030).[7] Both the Union and its Member States participated in the Biodiversity Framework,[8] which means that they must use all policy tools necessary to reach the targets set therein including fiscal instruments. Indeed, biodiversity-relevant taxes have been on the increase globally since 1980,[9] and recent economists have pointed out the usefulness of tropical carbon taxes in simultaneously tackling the twin threats of climate change and biodiversity loss.[10]

In light of the above, this paper analyzes the Member States' latitude of maneuver in their adoption of environmental tax policies which pursue current climate change and nature restoration ambitions. Given the evolving nature of environmental taxes, the author has decided to focus only on the essentials. This paper does not provide a description of all environmental taxes in Europe. Instead, it takes the elementary features of such taxes and tests them under the provisions of Union law as interpreted by the Court of Justice. In particular, the author searches for an answer to the question of which types of environmental tax are incompatible with the internal market. That question can be subdivided as follows: to what extent can a Member State adopt fiscal tools to: (i) discourage methods of production, distribution and consumption of products and services considered destructive to our planet; and (ii) promote the production, distribution and consumption of products and services that are respectful of our environment.

[7] *See* UN Environment Assembly decision, Kunming-Montreal Global Biodiversity Framework (GBF), at 1-3 (Dec. 19, 2022).

[8] *See* European Commission Press Release IP/22/7834, COP15: Historic global deal for nature and people (Dec. 19, 2022).

[9] *See* Organization for economic cooperation and development [OECD], *Tracking Economic Instruments and Finance for Biodiversity,* at 5 (2021) https://www.oecd.org/environment/resources/biodiversity/tracking-economic-instruments-and-finance-for-biodiversity-2021.pdf.

[10] *See* E. B. Barbier, R. Lozano, C.M. Rodriguez & S. Troëng, *Adopt a carbon tax to protect tropical forests*, NATURE, (Feb. 12, 2020), https://www.nature.com/articles/d41586-020-00324-w. According to the authors, a tropical carbon tax will finance adaptation and mitigation initiatives in biodiversity-rich countries where private investment alone has not registered much progress in this regard.

To answer these questions, the paper is divided into two sections and addresses both the proscriptive and the permissive facets of Union law in this sector. In the first section, the author analyzes the theoretical and legal foundations of tax instruments that are intended to protect not just a national but also the *European* environment. In the second section, the author then deals directly with the compatibility of environmental taxes with Union law. Since the scope of this paper is environmental *taxation,* generally, other complex market-intervention measures conceived to fight climate change (such as the E.U. Emissions Trading System) will only be discussed briefly and to the extent that they serve to place matters in their proper context.[11]

Throughout the paper, one sees that a unique paradox exists in Europe. While it is the Member States who possess the major fiscal initiative to deal with the current environmental emergency, the use of fiscal tools has implications for the entire Union and its citizens.[12] Therefore, the author also explains how the current division of competences within the field of taxation conditions the type, the extent, and the quality of the fiscal solutions available. One point to be made here is that the current division of competences has not set things in stone. The field of environmental taxation is moving, and it is moving fast. As we speak, major proposals in the field are being discussed within the institutions, such as the proposal for a new minimum tax on aviation fuel, the Carbon Border Adjustment Mechanism [hereinafter C.B.A.M.] proposal, or even the latest calls for a Union-wide windfall tax.[13] It is precisely in these urgent times that one cannot help but think that the deeper into crisis the world plunges, the bolder and swifter E.U. action in this field will become.

[11] For the differences and interactions between environmental taxes and market-based mechanisms such as the European Union Emission Trading Scheme [hereinafter E.U. E.T.S.], see Organization for economic cooperation and development [OECD], *Environmentally Related Taxes and Tradable Permit Systems in Practice*, COM/ENV/EPOC/CTPA/CFA(2007)31/FINAL, (2008), https://one.oecd.org/document/com/env/epoc/ctpa/cfa(2007)31/final/en/pdf; see also Organisation for economic cooperation and development [OECD], *Interactions Between Emission Trading Systems and Other Overlapping Policy Instruments*, COM/ENV/EPOC/CTPA/CFA(2011)4/FINAL, (2011), https://www.oecd.org/env/tools-evaluation/Interactions%20between%20Emission%20Trading%20Systems%20and%20Other%20Overlapping%20Policy%20Instruments.pdf.

[12] *See* Alina Vysochnya et al., *Convergence trends of environmental taxation in European countries*, E3S WEB CONF. 1, 2 (2020).

[13] *See* Resolution on the E.U.'s response to the increase in energy prices in Europe, Eur. Parl. Doc. PV 58(II) (1994).2022/2830(RSP), (2022), https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2022/2830(RSP).

1. CAN AN INTRINSICALLY EUROPEAN ENVIRONMENT BE PROTECTED BY NATIONAL FISCAL REGIMES?

While environmental protection is a global goal enshrined in the United Nations Sustainable Development Goals [U.N SDGs] and the Treaty on the Functioning of the European Union [hereinafter T.F.E.U.],[14] tax regimes see their application boxed into the four corners of each Member State. This is due to the age-old principle of international law that a sovereign state does not recognize and enforce the taxes of other sovereign states in its own territory. So how can one or a few Member States truly make a difference at the global level? With the environmental landscape that stretches from the French overseas territories to the ancient forests on Poland's eastern border, one question which arises is whether a Member State can adopt an environmental tax policy which affects trade both in its own territory and in other parts of the Union. We will see that the territorial confines of tax regimes in general have not prevented them from targeting harmful activities or goods which originate abroad. Indeed, a large part of the case-law on the free movement of goods concerns fiscal measures adopted by one Member State on goods originating in another Member State - sometimes on the basis that such measures protect the environment defined in the broadest sense. These types of measures can be especially effective if demand for a particular good or service is concentrated within the Member State that decides to tax it. Any tax imposed on such goods or services is very likely to affect production abroad by influencing consumers back home. Therefore, the idea that fiscal measures, albeit territorial, may still pursue a general vocation to protect the environment, wherever that environment may be situated. And this has given rise to a functional theory of environmental taxation which inspires legislators to this day. It is this theory which serves as the rational basis for the measures and legislative acts of Member States and the Union respectively.[15] It is in the second Paragraph that we ask the question of whether a European-wide environmental tax, based on the theory discussed in the first Paragraph, is at all legally possible.

[14] Consolidated versions of the Treaty on the Functioning of the European Union art. 191(1), June 7, 2016, 2016 O.J. (C 202) 47 [hereinafter TFEU]; UN Department of Economic and Social Affairs, sustainable development goals, (jan. 29, 2023) https://sdgs.un.org/goals, see Goals 11-15.

[15] This theory has been reproduced in Communication from the Commission, see *Communication from the Commission, Guidelines on State aid for climate, environmental protection and energy 2022, at 8-9,* COM (2022) C 80/01 (Feb. 18, 2022)[hereinafter C.E.E.A.G.].

1.1. THE THEORY UNDERLYING MODERN ENVIRONMENTAL TAXATION

An environmental tax can be defined simply as "a tax whose tax base is a physical unit (or a proxy of a physical unit) of something that has a proven, specific negative impact on the environment".[16] It is nothing more than a charge imposed on taxpayers that is sensitive to the environmental damage caused by human activities, notably large-scale industry that has become dominant due to the globalisation of value chains. The Organisation for Economic Co-operation and Development [hereinafter O.E.C.D.] offers an even more detailed definition: "Environment-related taxes are any compulsory, unrequited payment to the general government levied on tax-bases deemed to be of particular environmental relevance".[17] In this regard, the environmental taxes most found in European countries include taxes on energy products, motor vehicles, waste, pollutant emissions, and natural resource exploitation.[18]

But why use taxation to achieve environmental goals? To answer this we must first look at the two principal alternatives. The traditional alternative to environmental taxes is regulation. This instrument functions on the idea that actors should incur pecuniary, administrative or penal sanctions when they fail to respect precise environmental obligations laid down by law.[19] Environmental regulation and environmental taxation are not diametrically opposed, and a recent O.E.C.D. report highlights their synergetic effects on the restoration of ecosystems (regulation restricts activity while tax can create positive incentives for restoration by ensuring that the true costs of degradation are appropriately priced into economic activity).[20] A more modern alternative may be found in a hybrid system that combines both regulatory and fiscal elements. Such is the negotiable permit (market) mechanism which lays out rules for the concession of "permits to pollute" through State auction. These permits allow their acquirer to release a given volume of pollution into the environment over a given period

[16] *See* Eurostat, Environmental taxes: A statistical guide, at 9, (2013) https://ec.europa.eu/eurostat/documents/3859598/5936129/KS-GQ-13-005-EN.PDF.pdf/706eda9f-93a8-44ab-900c-ba8c2557ddb0?t=1414782946000. See also Regulation 2011/691, of the European Parliament and of the Council of 6 July 2011 on European environmental economic accounts, art. 2(2), 2011 O.J. (L192) 1, which contains an identical definition.

[17] Organization for economic cooperation and development [OECD], *The Political Economy of Environmentally Related Taxes,* at 26, (2006), https://www.oecd.org/env/tools-evaluation/thepoliticaleconomyofenvironmentallyrelatedtaxes.htm.

[18] *See generally* Adriano Di Pietro, La fiscalita' ambientale in Europa e per l'Europa [Environmental Taxation in and for Europe] 52 (Cacucci ed., 2016) (It.).

[19] *See* V. Sepulchre, La Fiscalite Environnementale en Belgique [Environmental taxation in Belgium] 11 (Larcier eds., 2009).

[20] *See* Report of the Organization for Econmic cooperation and development [OECD], *Biodiversity: Finance and the Economic Business Case for Action prepared for the G7 Environment Ministers Meeting of 5-6 May 2019,* at 51, (2019), https://www.oecd.org/environment/resources/biodiversity/G7-report-Biodiversity-Finance-and-the-Economic-and-Business-Case-for-Action.pdf.

and may be freely exchanged with economic actors. Under this system, operators facing high costs for reducing their emissions will attempt to buy permits from operators incurring lower costs for such a reduction. The intended effect is to drive operators towards more efficient modes of production. It is worth noting that a system of negotiable pollution permits is not based on Pigouvian theories of internalising externalities,[21] and its principal setback lies in the fact that its design, in practice, can only cover certain targeted sectors of economic activity.[22]

According to some authors, since fiscal instruments are more flexible than regulation they can eliminate environmental problems by creating a double effect.[23] On the one hand, they stimulate the economy through incentives. And on the other, they discourage environmentally harmful activities through expansion of the tax base and increase in the rate of environmental taxes.[24] Taking the above-cited definitions, it is hard not to notice that they are built around the idea of discouraging human activities which are harmful to the planet. Indeed, their common basis is the internalisation of negative externalities (i.e., environmental damage), caused by the production, distribution and consumption of a product or service into the cost of that same product or service. This additional cost, once passed on to the consumer, will make him choose whether to pay more for a product or service that is of greater cost to the environment.

We cannot talk about environmental externalities without mentioning the work of Arthur C. Pigou.[25] The British economist had theorised a type of "corrective taxation" that compensated for the negative externalities of goods traded on the market, such as pollution. This laid the basis for the famous Pigouvian tax,[26] which takes the form of an indirect tax on harmful goods or activities and which serves as inspiration for the polluter-pays principle.[27] According to Pigou, a negative externality could be categorised as a market failure because its external cost was passed on to society at large rather than being reflected in the price set by the seller and buyer (the parties to a contract do not normally factor social costs into the agreed price).[28] This phenomenon resulted in the creation of economic inefficiencies that could not be taken into account by the economic models of the time. Applying the polluter-pays principle to the private individuals signifies that it is the person who makes use of or puts the product into circulation who must bear the cost of compensating the negative externality.

[21] *See* Sepulchre, *supra* note 19, at 23.
[22] *See id.* at 29.
[23] *See id.* at 13.
[24] *See* Vysochnya, *supra* note 12, at 3.
[25] *See* A. C. PIGOU, THE ECONOMICS OF WELFARE (Palgrave Macmillan, 4th ed. 1932); *see also* NICOLAS CARUANA, LA FISCALITE ENVIRONNEMENTALE [ENVIRONMENTAL TAXATION], 69-78 (L'Harmattan ed., 2015).
[26] *See* R. C. Williams III, *Environmental Taxation* 2 (National Bureau of Economic Research: Working Paper 22303, 2016).
[27] *See* Caruana, *supra* note 25, at 80.
[28] *See* Pigou, *supra* note 25, at 185-86.

According to Pigou, only a tax imposed on the harmful product could correct an externality.[29] If the tax equals the external damage caused to society by one unit in addition to the product, the damage will be compensated by the price of the transaction, forcing the buyer to pay the marginal social cost of the product as well.[30] This tax encourages operators to reduce the externalities of their products so as to attract more buyers; it therefore shifts demand in favour of products that cost less to society in general.

While sound in theory, the theory of negative externalities suffers some major difficulties when put into practice. First, the degree of damage caused by a product is very difficult to calculate. Pollutants diffuse easily and can persist in the environment for several decades, thus requiring calculations to be made on the future environmental effects of certain productions. Secondly, the intricate design of a Pigouvian tax may create large administrative costs for fiscal authorities.[31] Thirdly, political acceptance of Pigouvian taxes may be lacking in certain countries as they may be considered to impose an unfair burden on low-income households - while allowing those who can afford it to pollute to their heart's content.

Quite apart from their compensatory nature, environmental taxes can be a good source of government revenue. From this perspective, environmental taxes may be used, not only to correct negative externalities, but also to contribute to the State's public expenses.[32] This idea has given rise to the modern "double-dividend" theory. According to this theory, a shift towards the levy of environmental taxes will allow Member States to reform their tax systems in such a way as to achieve a high level of environmental protection with a lower rate of unemployment (without increasing the overall tax burden in Member States).[33] To achieve this, Member States need to review the very nature of our current tax systems, which are still mainly based on general income tax provisions. The principle underpinning the double-dividend theory is that Member States should increase taxation on anti-social activities (such as pollution), in order to be able to decrease taxation on human activities that are considered virtuous (such as labour).[34]

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[29] Pigou envisaged a tax system which would make private marginal cost match social marginal cost. However, he remains a liberal economist who did not recommend a systematic form of state intervention outside the realm of taxation: *see* Caruana, *supra* note 25, at 76-77.

[30] *See* Williams, *supra* note 26, at 3.

[31] *See* OECD, *supra* note 17, at 21.

[32] *See* Williams, *supra* note 26, at 4.

[33] *See Commission proposal for a Council Directive of 12 March 1997 restructuring the Community framework for the taxation of energy products,* at 1-2, COM(97) 30 final, (Mar. 12, 1997).

[34] *See generally* David Luckin & Simon Lightfoot, *Environmental taxation in contemporary European politics*, 5 CONTEMP. POL. 243, 249 (1999).

1.2. IS A UNION-WIDE ENVIRONMENTAL TAX POSSIBLE?

1.2.1. SOME PRELIMINARY CLARIFICATIONS

Many experts have communicated their wish to create a single instrument harmonising environmental taxation at the supranational level. One can note three major movements in the evolution of environmental taxes within the Union. For a long period, all was left in the hands of the Member States.[35] In the 1980s, there was a slow progression towards higher levels of environmental levies.[36] Everything accelerated in the 1990s when the Nordic countries adopted the first legislation against climate change.[37] Soon afterwards, environmental taxation quickly lost its popularity and, from 2007 onwards, fell back to its 1980s level.[38] Current Eurostat statistics show that environmental tax revenues represent only 2.2% of E.U. Gross Domestic Product (G.D.P.); 77.2% of these revenues being due to energy taxes.[39]

As for the latter statistic, it is worth pointing out that not all energy taxes pursue environmental objectives. Historically, they have been used as a broad instrument for Member States to raise revenues. Such was, after all, the initial motivation behind the Energy Taxation Directive - although the Commission has admitted that the environmental aspect of this directive has now gained relevance.[40] Moreover, the Joint Research Council has demonstrated that excise taxes on energy consumption (as well as related emissions and resource use) do not necessarily converge with classical Pigouvian theory, as Member States often resort to such taxes to achieve other goals, such as fixing distortions in the energy market or achieving socio-economic objectives.[41] Paradoxically, the more effective a carbon tax levied on fossil fuels is at penalising their use and shifting behaviour towards cleaner methods of energy production, the greater the reduction in a Member State's tax base will be.

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[35] *See generally* ELOI LAURENT & JACQUES LE CACHEUX, UNE UNION SANS CESSE MOINS CARBONEE ? [A Union with Increasingly Less Carbon?] 26 (Notre Europe ed., 2009) (Fr.).

[36] *See id.*

[37] *See id.*

[38] *Id.*

[39] *See Eurostat Website, Environmental tax statistics*, (April 24, 2022), https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Environmental_tax_statistics&action=statexp-seat&lang=fr; *see also* R. Hertzog, *Pourquoi la fiscalité de l'environnement ne prospère pas* [*Why Environmental Taxation is Not Flourishing*], GESTION & FINANCES PUBLIQUES [MGMT. & PUB. FIN.] 51 (2021) (Fr.).

[40] *See* European Environment Agency (EEA), *The role of (environmental) taxation in supporting sustainability transitions*, Briefing no. 22/2021, at 17 (Jan. 30, 2023) https://www.eea.europa.eu/publications/the-role-of-environmental-taxation.

[41] *Joint Research Council science for policy report on the Energy Taxation and its Societal Effects,* at 8-9, EUR 30552 EN, (Jan. 14, 2021).

Since the adoption of the "Fit for 55" package,[42] the Commission is now committed to align its energy policy with its climate objectives, thereby placing greater emphasis on the environmental aspects of energy taxation.[43]

Coming back to our discussion regarding a possible European environmental tax, two statements are worth noting since they witness the first efforts to initiate environmental tax reform at supranational level. In 1998, the European Environment Agency (E.E.A.) published a communication indicating the great potential for job creation that a European-wide environmental tax reform could bring.[44] At the European Council in Copenhagen, the then President of the Commission, Jacques Delors, went as far as communicating his preference in favour of a new European double-dividend tax policy.[45] We feel that these very general statements in favour of promoting environmental taxes in Europe can be misleading since they fail to explain the type of concrete measures envisaged by the people making them. They therefore require some clarification.

When in the realm of taxation more generally, a distinction must be drawn between, first, the power to create a purely European tax which contributes to the Union's budgetary resources, secondly, the power to obligate Member States to tax persons, products or services in a certain manner and, thirdly, national taxes adopted on the Member States' initiative and which are only legal in so far as they are compatible with Union law, including secondary legislation. It suffices to say that regarding the first type of tax (or purely European tax) the Union has no competence to impose taxes directly on Union citizens or residents.[46] This would require a total revision of the treaties, as there is currently no single treaty article which confers this power on any of the Union's institutions. So, the statements calling for a regional and purely European environmental tax must be interpreted as excluding this possibility, simply because the Treaties do not and have not envisaged it since the Treaty of Rome.

The second and third scenarios are discussed further below.

[42] *Communication from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Committee of the Regions, "Fit for 55": delivering the E.U.'s 2030 Climate Target on the way to climate neutrality,* COM (2021) 550 final (July 14, 2021).

[43] *See Commission proposal for a Council Directive, restructuring the Union framework for the taxation of energy products and electricity (recast),* COM (2021) 563 final (July 14, 2021).

[44] *European Environment Agency (EEA), Environmental Taxes: Implementation and Environmental Effectiveness,* at 7, (Aug. 1996), https://www.eea.europa.eu/publications/92-9167-000-6/file.

[45] Bulletin des Communautés européennes No 6/93, at 18 (1993).

[46] *See* V. Dussart, *L'impossible création d'un impôt européen?* [*Is the Introduction of a European Tax Impossible?*], 144 REVUE FRANÇAISE D'ADMINISTRATION PUBLIQUE [FRENCH REV. PUB. ADMIN.] 1085, 1088 (2012) (Fr.).

1.2.2. LIMITED LEGAL BASES FOR EUROPEAN ACTION

The Treaties offer few legal bases by virtue of which the Union can act in tax matters. Those legal bases, as we shall see, are in turn modelled around the strict dichotomy between direct and indirect taxes, thereby conditioning the type of legal act the Union can adopt in the direct and indirect tax fields. Coming back to the distinction drawn in the last Subparagraph, we can say that the Union, although lacking the power to impose its own taxes, may force Member States to tax (or not to tax) a particular product, service, person, or activity. The main legal bases for doing so are Articles 113 and 115 T.F.E.U.

Direct taxes do not fit easily into the definitions of environmental taxes cited earlier in this Section. However, it is not impossible to imagine a tax system which charges profits differently according to the harmfulness of the principal activity generating them. Such a system may, for instance, be used to incentivise a double shift towards less harmful production methods and employment. Furthermore, there is nothing generally to prevent a Member State from granting tax breaks on profits generated from activities related to environmental protection, provided that state aid rules on selectivity are observed. In this respect, the Court has refused to recognise any argument in favour of automatically excluding a fiscal measure from the scope of Article 107 T.F.E.U., particularly the criteria on material selectivity, simply because it pursues an environmental protection objective (see the discussion in Paragraph 2.3 below).

At this stage, the question one would need to answer is whether the Union has the competence, at all, to adopt measures for the harmonisation of direct and indirect environmental taxes. Article 115 T.F.E.U. enables the Council to act unanimously under a special legislative procedure with a view to issue *directives* for the approximation of such laws, regulations or administrative provisions of the Member States as directly affecting the establishment or functioning of the internal market. Only directives can be used to harmonise national tax provisions, thereby excluding the use of regulations which aim to uniformise direct taxes, and the harmonisation must have as its object of improvement of the conditions for "the establishment or functioning of the internal market".[47] In the author's view, this latter element was introduced into the Treaty of Rome to ensure that the Union will not be able to harmonise indiscriminately, but only to the extent necessary to be able to reinforce and guarantee the exercise of the fundamental freedoms of Union citizens. In no case can the Union harmonise on the simple pretext that it wishes to replace

[47] Case C-376/98, Tobacco Advertising I, 2000 E.C.R I-08419, ¶ 83.

the Member States' tax systems with a system which it believes is better suited to meet the objectives it sets for itself.

Another striking feature of Article 115 is the requirement of unanimity. While some inroads have been made in the field of direct taxation, the diversity of fiscal policies between Member States means that a total harmonisation of Member States' tax bases is almost impossible to achieve. On this point, De Sadeleer notes that the special legislative procedure,where the Council is the sole legislator and decides by unanimity, used since the Treaty of Rome to harmonise the tax provisions of the Member States, has prevented the adoption of a holistic system of environmental taxation at the supranational level.[48] Indeed, since the 1978 Spinelli Report, the creation of a direct tax at the European level, even if levied by the Member States, remains impossible in practice, since it would require the harmonisation of the tax bases of the Member States to such an extent that all disparities between them would be eliminated.[49] Naturally, while Member State sovereignty is currently the rule in the area of direct taxation, this does not mean that European law has no impact on the design of direct taxes. National tax provisions adopted in areas not subject to harmonisation must still comply with the fundamental freedoms and the fundamental rights set out in the Charter.[50] In other words, where a Member State adopts fiscal tools to incentivise a green transition towards environmentally friendly jobs or production processes, the provisions governing the granting of state aid, freedom of establishment and free movement of workers remain applicable.[51]

Historically, the Commission's initiatives to introduce environmental taxes have tended to focus on indirect taxes, i.e., taxes on transactions. Indeed, the first indirect tax in the history of the Union was envisaged by the Delors Commission with the creation of a CO2 ecotax. This initiative was rejected in 1992 by the Ecofin Council.[52] Nevertheless, it seems that the Commission retains a strong belief in this approach. Since the Lisbon Treaty, the current legal basis for the harmonisation of indirect taxes is found in Article 113 T.F.E.U.[53] According to this Article, the Council, acting unanimously in accordance with a special legislative procedure, shall adopt *provisions* for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation. Once again, the Council may act only to the extent that harmonisation is necessary to

[48] NICOLAS DE SADELEER, EU ENVIRONMENTAL LAW AND THE INTERNAL MARKET 238 (Oxford University Press ed., 2014) (UK).
[49] *See* Dussart, *supra* note 46, at 1088; *see also* ALEXANDRE MAITROT DE LA MOTTE, DROIT FISCAL DE L'UNIONS EUROPEENNE [European Union tax law] 27-35 (Bruylant ed., 3rd ed. 2022) (Fr.).
[50] *See* Case C-446/03, Marks & Spencer plc, 2005 E.C.R. I-10837, ¶ 29.
[51] *See* PETER J. WATTEL ET AL., EUROPEAN TAX LAW, VOLUME I, 12 (Wolters Kluwer ed., 7th ed. 2018).
[52] *See* Dussart, *supra* note 46, at 1089.
[53] *See* Wattel et al., *supra* note 51, at 34.

ensure the establishment and functioning of the internal market and to avoid distortions of competition. Article 113 T.F.E.U. is considered by some authors as conferring a specific mandate on the Union to bring about a holistic and positive harmonisation of the internal market, such a mandate not being readily identifiable in the case of direct taxes.[54] Over time, the Union has adopted or proposed several legislative acts on the basis of Article 113 T.F.E.U. that have an impact on national environmental tax provisions such as the Energy Products Tax Directive,[55] the Excise Directive,[56] the Heavy Vehicle Tax directive,[57] and the Proposal for a Directive on Passenger Car Related Taxes.[58]

A third legal basis for the harmonisation of national environmental taxes has been inserted into the Treaties by the Single European Act. Article 192(2)(a) T.F.E.U. is more specific, and allows for the adoption of "provisions primarily of a fiscal nature" in the Union's promotion of a coherent European environmental policy. According to this Article, the Council shall, before adopting fiscal measures of an environmental nature, act unanimously in accordance with a special legislative procedure, and only after consulting the Parliament, the Economic and Social Committee and the Committee of the Regions. A couple of remarks can be made at this stage. First, the unanimity requirement in Article 192(2)(a) has been inserted to ensure that the article is not used to bypass the other legal bases discussed above. Secondly, any tax measures adopted on the basis of this Article must have a primarily environmental character and be based on the polluter-pays principle. Thirdly, although the wording of Article 192(2)(a) encapsulates the general principle that the Union will only harmonise exceptionally in the field of taxation, there is one stark difference between this article and Articles 113 and 115 T.F.E.U.: for the Council to be able to adopt a fiscal measure of an environmental character, there need not be a link subsisting between the measure and the need to ensure the proper functioning of the internal market. This means that the pure objective of environmental protection may be freely pursued when harmonising environmental taxes under Article 192(2)(a). The Directive establishing a scheme for greenhouse gas emission allowance trading within the Union,[59] as well as the proposed regulation for a C.B.A.M.,[60] are based on Article 192(2)(a) T.F.E.U.

[54] *Id.*
[55] Council Directive 2003/96, 2003 O.J. (L 283) 51 (EC).
[56] Council Directive 2020/262, 2020 O.J. (L 58) 4 (EU).
[57] Directive 1999/62/EC, of the European Parliament and of the Council of 17 June 1999 on the charging of heavy goods vehicles for the use of certain infrastructures, 1999 O.J. (L 187).
[58] *Commission Proposal for a Council Directive on passenger car related taxes,* COM (2005) 261 final (July 5, 2005).
[59] Directive 2003/87/EC, of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, 2003 O.J. (L 275) 32.
[60] *Commission proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism*, COM (2021) 564 final (July 14, 2021).

At this point, it would be interesting to know the precise scope of the words "provisions primarily of a fiscal nature". This is because under the general scheme of Article 192, an environmental measure not of a fiscal nature can be adopted through the ordinary legislative procedure. The response is not easy and can indeed depend on the legal culture and background of the person interpreting the words. What is sure is that at the European level there is no definition of "tax" and charges aiming to protect the environment which can serve eminently regulatory purposes too. This could open a whole debate about what is essentially "fiscal" in nature and what is not. It suffices to say that according to the classic definition attributed to Gaston Jèze, there is no tax that does not serve to cover public expenses.[61] We have seen that what may be generally called an environmental tax or charge may not necessarily be designed with the purpose of increasing government revenues, but to force a polluter to pay for the damage he has caused to society (in line with the polluter-pays principle derived from the Pigouvian theory of externalities).[62] As Caruana says, environmental taxation is an ambivalent notion,[63] and can manifest itself as a sanction-type measure to be found often in instruments of a regulatory character.[64] The question has not been addressed by the Court, but an instrument like the Energy Taxation Directive has generally been taken to contain "fiscal" measures despite the fact that one of its objectives is to ensure that some of the damage caused by the consumption of fossil fuels is compensated through a minimum rate of taxation.[65]

1.3. PRELIMINARY CONCLUSIONS PROVIDING A STRUCTURE FOR THE SECOND PART OF THIS PAPER

Paragraph 1.1. has discussed the general theory underpinning environmental taxes. According to this theory, environmental taxes serve to internalise negative externalities into the costs of products and services on the market. In Section 1.2 we saw that a system of environmental taxation in Europe is possible, but the current division of competences has brought about a situation where Union intervention is entirely sectoral and heavily

[61] *See* Maitrot De La Motte, *supra* note 49, at 44: où l'impôt est défini comme une «prestation pécuniaire requise des particuliers par voie d'autorité, à titre définitif et sans contrepartie, *en vue de la couverture des charges publiques*» [where tax is defined as «a pecuniary benefit required from individuals by means of authority, definitively and without compensation, for the purpose of covering public charges»].

[62] *See* Caruana, *supra* note 25, at 78-89.

[63] *See* Di Pietro, *supra* note 18, at 83: ". . . non esiste un'apposita e autonoma disciplina positiva della fiscalità ambientale. . .la fiscalità ambientale si presenta come un sistema eterogeneo e frammentato e, soprattutto, privo di disposizioni organiche" ["there is not a specific and autonomous positive regulation of environmental taxation. . .environmental taxation is a heterogeneous and fragmented system, and, above all, without organic provisions"].

[64] Caruana, *supra* note 25, at 289; *see also* Hervé Raimana Lallemant-Moe, *Les Deux Visages de l'impôt à finalité écologique* [The Two Faces of the Ecological Tax], 161 POUVOIRS 147, 151-52 (2017).

[65] Council Directive 2003/96, *supra* note 55, at Preambles 6-7.

focused on the creation of indirect taxes. It is, as yet, highly doubtful whether a holistic harmonisation of direct taxes in pursuit of a green transition is possible, since this would require all Member States to renounce their sovereign tax base. Such an outcome can hardly be said to have been envisaged by the treaty drafters. However, Article 115 T.F.E.U. allows the Union to harmonise the direct tax laws of the Member States, albeit limited to the extent that these directly affect the establishment or functioning of the internal market. This latter requirement limits all attempts to harmonise direct environmental taxes to the achievement of very specific goals. The imposition of a one-time retroactive "windfall" tax on fossil fuel companies could be one example, although politically difficult to achieve in practice.

We now propose approaching Section 2 of this paper in the following manner. Our focus will turn to the case-law of the Court which deals directly with the compatibility of national environmental taxes with various provisions of Union law, including the fundamental freedoms (Paragraph 2.1) and pieces of secondary legislation (Paragraph 2.2). Finally, the assessment of environmental taxes under the state aid provisions will be tackled (Paragraph 2.3).

2. THE COMPATIBILITY OF ENVIRONMENTAL TAXES WITH UNION LAW

Since the Treaty of Rome, the process of economic integration in Europe has been based on the free market with the Court of Justice of the European Union taking on the role of guardian of the internal market. Neo-protectionist measures incompatible with the fundamental freedoms of the Treaties were quickly set aside by the jurisprudence of the Court. In this second part of the paper, we discuss whether that jurisprudence has any bearing on the creation of environmental taxes by the Member States.

2.1. ENVIRONMENTAL TAXES AND FUNDAMENTAL FREEDOMS

The compatibility of any environmental measure adopted by Member States is assessed in a twofold way. If there is an act of secondary legislation fully harmonising an aspect of the internal market, and the measure falls within the scope of that act, it will be assessed in accordance with its provisions. If, on the other hand, there is no act harmonising an area of the internal market, or if the harmonisation is not complete, the legality of the environmental measure will be assessed in the light of the Treaties.[66]

2.1.1. FREE MOVEMENT OF GOODS

When studying the free movement of goods, a distinction is made between fiscal (or tariff) barriers on the one hand (Sub-Subparagraph 2.1.1.1.), and non-fiscal barriers on the other (Sub-Subparagraph 2.1.1.2.). In this paper, we will focus mainly on the former, i.e., the prohibitions contained in Articles 28 to 30 and 110 T.F.E.U. We will discuss non-tax barriers (Articles 34 to 36 T.F.E.U.) only insofar as they might be relevant to the implementation and collection of environmental taxes by Member States.

2.1.1.1. FISCAL BARRIERS TO TRADE

Our starting point is the observation that there is no harmonisation of environmental taxes in Europe. As a result, Member States are free to implement their own environmental tax policy,[67] a freedom that manifests itself through the differences in the base and rate of environmental taxes within the Union.[68] However, the fiscal autonomy of Member States is not absolute, as they are bound by the Treaties when introducing new environmental taxes.[69]

Normally, the financial nature of an environmental tax is sufficient to bring it within the scope of Articles 28 to 30 and 110 T.F.E.U., with the consequence that the Treaty articles dealing with quantitative measures are excluded.[70] What distinguishes customs duties and charges, having an equivalent effect to customs duties [hereinafter C.E.E.], from internal taxation is their operative event. According to the Court's definition, a C.E.E. is a "*pecuniary charge. . .imposed unilaterally on domestic or foreign goods by reason of the fact that they cross a frontier, and which is not a custom's duty in the strict sense* [. . .]".[71] By contrast, an internal tax is a charge "under a general system of internal

[66] *See* De Sadeleer, *supra* note 48, at 230-31.
[67] *Id.* at 238.
[68] *Id.* at 239.
[69] *Id.*
[70] *Id.* at 240.
[71] *See* Case C-24/68, Comm'n v. Italy, 1969 E.C.R. 193, ¶ 9.

charges applying systematically to domestic and imported products according to the same criteria".[72]

2.1.1.1.1. ARTICLES 28 TO 30 T.F.E.U.

The Customs Union is a fundamental part of the Union and is based on three things: a single external border; a single customs tariff; and a common legislative framework.[73] Article 28 T.F.E.U. provides that the Union shall comprise a customs union covering all trade in goods including the prohibition between Member States of customs duties on imports and exports; and of all charges having equivalent effect; and the adoption of a common customs tariff in their relations with third countries. Article 3 T.F.E.U. provides that the Union has exclusive competence in this area. It is therefore not open to Member States to legislate in this area. Any possibility of introducing a tariff regime, whether protective of the environment or not, is thereby excluded.

The Court has always applied the tariff prohibition rigorously, particularly, because of the automatically discriminatory and protectionist nature of these types of charges.[74] From the outset of its jurisprudence, the Court decided that the goal of protecting the environment cannot in any way justify these charges.[75] And, in addition, the revenues collected by customs tariffs used to finance, or in some way carry out, a national environmental policy, have no bearing on the classification of a customs tariff.[76] In principle, even the smallest charges are prohibited and the form, description and method of collection of the charge do not affect its classification as a C.E.E.[77]

The Court's rigorous approach is illustrated in Case C-72/03.[78] The municipality of Carrara in Italy had imposed a tax on the export of marble extracted on its territory with a rate that changed according to the weight of the marble. The Court declared such a tax incompatible with Article 30 T.F.E.U. because its chargeable event was the crossing of the municipality's borders by the marbles. It specified that the fact that the tax was levied to compensate for damage caused to the municipality by the marble industry could

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[72] *See* Case C-130/96, Fazenda Pública v. Solisnor-Estaleiros Navais SA, 1997 E.C.R. I-5053; Case C-28/96, Fazenda Pública v. Fricarnes SA, 1997 E.C.R. I-4939, ¶ 21.

[73] *See* Marie Lamensch et al., European Tax law, Volume II 3 (Wolters Kluwer ed., 2018) (Neth.).

[74] *See* Catherine Barnard, The Substantive Law of the EU 42-45 (Oxford University Press ed., 6th ed. 2019) (UK).

[75] *See* Case 2-69, Diamantarbeiders, 1969 E.C.R. 211, ¶ 19; Case 29/72, S.p.A. Marimex v. Italian Fin. Admin., 1972 E.C.R. 1309, ¶ 7.

[76] *See also* De Sadeleer, *supra* note 48, at 242.

[77] *See also id.*

[78] *See* Case C-72/03, Carbonati Apuani Srl v. Comune di Carrara, 2004 E.C.R. I-8027.

not alter the solution adopted. Therefore, a C.E.E. cannot be justified, even if the money collected is used to maintain the urban or natural environment of a municipality.

Another Italian case before the Court concerned a tax imposed on the consumption of natural gas (from Algeria) on Italian territory.[79] A law of the Sicilian region provided for a tax on the ownership of gas pipelines that transported methane gas through Sicilian territory. The basis of the tax was the volume of the pipelines: i.e., the more methane gas was transported, the more was paid. For the Commission, the tax constituted a C.E.E. despite its environmental purpose. On the other hand, the Italian Government argued that the precautionary principle (a general principle of law contained in the Treaties) allowed for the introduction of such a tax despite the provisions of Article 30 T.F.E.U. The Court, having noted that the environmental tax was intended to finance investments aimed at reducing and preventing risks to the environment, declared it incompatible with that Article. Such is the strength of the prohibition on the use of C.E.E.s to achieve environmental objectives.

The Court recognizes only two exceptions to the application of Articles 28 and 30 T.F.E.U.[80] First, if a pecuniary charge is imposed as consideration for a service rendered to the importer, such a service must confer a specific and certain benefit on the individual importer, as a benefit in the public interest is considered too general and uncertain by the Court.[81] For example, a service provided by public authorities for the recycling of waste generated by an importer may be considered to fall within this first exception - provided that the service is not mandatory and the amount charged is proportionate to the volume of waste generated by the importer.

The other exception to Articles 28 and 30 T.F.E.U. is the payment for an inspection made mandatory by Union law. In environmental matters, Article 29 of Regulation 1013/2006/EC on the shipment of waste between Member States provides that in the case of shipments of waste within the Union, appropriate and proportionate administrative costs for the implementation of notification and monitoring procedures and the usual costs of appropriate analyses and inspections may be charged, inter alia, to the waste producers.

The two exceptions to Article 30 T.F.E.U. were addressed jointly in Case C-389/00.[82] In Germany, exporters of waste, before exporting, had to pay a contribution to the solidarity fund for the return of waste to Germany. This fund was to be used to implement Germany's obligations under the Basel Convention, which stipulates that in

[79] *See* Case C-173/05, Comm'n v. Italy, 2007 E.C.R. I-4917.
[80] *See* Maitrot De La Motte, *supra* note 49, at 102-06.
[81] *See* Case C-305/17, FENS v. Slovak Rep., ECLI:EU:C:2018:986, ¶ 43 (Dec. 6, 2018).
[82] *See* Case C-389/00, Comm'n v. Germany, 2003 E.C.R. I-2001.

the event of illegal exporting or non-compliance with a waste export contract, the illegally exported waste had to be re-imported into Germany. The German Government considered the fee to be adequate remuneration for services actually and individually rendered to economic operators. According to the Court, the fact that the charge was determined exclusively on the basis of the type and quantity of waste to be shipped by each exporter meant that no individual service was rendered to the operators. In addition, the economic operators required to pay the fee did not derive any actual, individual benefit from the activities financed by the fund. With regard to Article 29 of Regulation 1013/2006/EC, the Court decided that this Article could not be used to impose charges on operators that are not justified or are not strictly related to the administrative costs incurred for the implementation of the procedures of notification and supervision of waste shipments.

2.1.1.1.2. ARTICLE 110 T.F.E.U.

While C.E.E.s are imposed unilaterally and hit goods because of the crossing of a border, Article 110 T.F.E.U. applies to taxes that are imposed within a Member State on both local and imported products.[83] A tax measure cannot fall simultaneously within the scope of Articles 28 to 30 T.F.E.U. and Article 110 T.F.E.U., since the two prohibitions are aimed at different tax charges altogether.[84]

Under Article 110 T.F.E.U., a Member State may adopt charges on foreign products provided it does not discriminate and the charge does not have a protectionist effect.[85] As Craig points out, Article 110 was inserted into the Treaty to ensure that competition between local and imported products is not distorted once the imported product enters the market of a Member State, and after having gone past the "operational event" that normally triggers C.E.E.s.[86]

According to the Court, the purpose of Article 110 T.F.E.U. is "[to eliminate] all forms of protection which might result from the application of discriminatory internal taxation against products from other Member States, and to guarantee absolute neutrality of internal taxation as regards competition between domestic and imported products".[87] It is therefore obvious that an environmental tax is only allowed if it is neutral, although neutrality often turns out to be a difficult notion to seize and apply on a case-by-case basis.

[83] *See* De Sadeleer, *supra* note 48, at 243.
[84] *See* Joined Cases C-78-83/90, Compagnie Commerciale de l'Ouest, 1992 E.C.R. I-1847, ¶ 22.
[85] *See* De Sadeleer, *supra* note 48, at 243.
[86] *See* P. Craig & G. De Burca, Eu Law: Text, Cases and Materials 682 (Oxford University Press ed., 7th ed. 2020).
[87] *See* Case 356/85, Comm'n v. Belgium, 1987 E.C.R. 3299, ¶ 6.

2.1.1.1.2.1. SIMILAR PRODUCTS

The first Paragraph of Article 110 T.F.E.U. prohibits discrimination between "like" products, while its second Paragraph prohibits any taxation of an imported product that is intended to "indirectly protect" other products. It is important to note that under Article 110 T.F.E.U., once the discriminatory or protectionist character of an internal tax is demonstrated, no justification is allowed by the text of the Treaty.

Let us start with the first Paragraph which prohibits Member States from taxing products from other Member States more heavily than similar local products.[88] In order to apply this Paragraph, it is necessary to find a product manufactured in the importing Member State that can present an alternative choice to the consumer by fulfilling the same function as the imported product.[89] If no such local production exists at all, the tax measure will not fall under Article 110 T.F.E.U., but it remains to be seen whether it is of such a nature as to be prohibited by Article 34 T.F.E.U. (see Sub-Sub-Subparagraph 2.1.1.2. below on non-pecuniary barriers). Once the "like" product is identified, the importing Member State must tax the imported product in the same way as the like local product. This rule extends not only to the rate of tax, but also to the provisions relating to the basis of taxation and the procedures for collection of the tax.[90]

One question that arises is whether similar products may be subject to a different tax rate, depending on their essential characteristics and their mode of production in light of the objective of environmental protection. It seems that the Court has accepted this possibility as an exception to the general prohibition imposed by Article 110 T.F.E.U.[91] In Case C-213/96,[92] Finland taxed domestically produced electricity at different rates in accordance with its mode of generation. On the contrary, it charged imported electricity at a single rate regardless of how it was generated. The differentiation in tax rates was based entirely on environmental considerations. At Paragraphs 30 and 31, the Court states that:

> . . .in its present state of development Community law does not restrict the freedom of each Member State to establish a tax system which differentiates between certain products, even products which are similar within the meaning of the first paragraph of Article [110 T.F.E.U.], on the basis of objective criteria, such as the nature of the

[88] *See* De Sadeleer, *supra* note 48, at 251.
[89] *See id.* at 252.
[90] *See* Case 55/79, Comm'n v. Ireland, 1980 E.C.R. 481.
[91] *See* Maitrot De La Motte, *supra* note 49, at 123.
[92] *See* Case C-213/96, Outokumpu Oy, 1998 E.C.R. I-1777.

> raw materials used or the production processes employed. Such differentiation is compatible with Community law, however, only if it pursues objectives which are themselves compatible with the requirements of the Treaty and its secondary legislation, and if the detailed rules are such as to avoid any form of discrimination, direct or indirect, against imports from other Member States or any form of protection of competing domestic products.
>
> Article [110 T.F.E.U.] therefore does not preclude the rate of an internal tax on electricity from varying according to the manner in which the electricity is produced and the raw materials used for its production, in so far as that differentiation is based, as is clear from the actual wording of the national court's questions, on environmental considerations.

On the merits, the Finnish tax infringed Article 110 T.F.E.U. because it failed to give importers of electricity the opportunity to benefit from the same differentiated system of taxation which applied to domestic production. The fact that it was difficult in practice to know how electricity from elsewhere was produced could not justify the difference in treatment imposed by the Finnish measure. The case is important for the principle it lays down. While it is possible for Member States to impose a heavier tax on a production method with a higher carbon footprint, Finland should at least have given the importer the opportunity to prove how the imported product was produced.[93] In this manner, the Court relayed the message that environmental taxation should be treated as any other form of taxation, and should not, in any case, be used as a tool to protect or promote local production. Taking the environmental protection objective of the measure as its point of reference, it came to the logical conclusion that imported electricity having a lower carbon footprint is equally beneficial to the environment as domestic electricity having the same qualities. The Finnish tax policy was therefore incoherent in not allowing imported electricity to benefit from a lower tax rate.

The Court has been called upon to assess several taxes of an environmental nature in its judgments on the registration of cars. In principle, an excise duty imposed on passenger cars and levied on the basis of various operative events having no connection with the product crossing borders between Member States (such as the registration or the intra-Community acquisition of the vehicle) falls within the scope of Article 110 T.F.E.U.[94] Furthermore, there is nothing under E.U. law to prevent the

[93] *See id.* ¶ 39.
[94] *See* Case C-313/05, Brzeziński, 2007 E.C.R. I-513, ¶¶ 22-24.

adoption of an excise duty with a different rate depending on the pollution emitted by a car. However, in accordance with the principle that an excise duty may not be imposed on products originating in other Member States more heavily than on similar domestic products,[95] an excise duty system must be designed in such a way that it does not favour the internal sale of vehicles that are already on the market of a Member State. Such a principle has greatly irritated those Member States wishing to protect their own second-hand markets in passenger vehicles.

In Case C-290/05, a Hungarian registration tax on used cars from other Member States based on their environmental classification, irrespective of their value and length of time in circulation, was declared incompatible with Article 110 T.F.E.U.[96] The Court clarified that a registration tax can be calculated based on the type of engine, engine capacity and environmental classification of the car. There is no requirement that the amount of the tax be strictly related to the price of the vehicle. However, it held that while a new vehicle on which registration tax was paid in Hungary could be resold at a percentage of its original value, including the residual amount of registration tax, a vehicle of the same model, age, mileage and other characteristics, purchased second-hand in another Member State and registered in Hungary, was subject to registration tax at the rate of 100%. Such a tax had discriminatory effects between second-hand vehicles already registered in Hungary and others that were imported after their initial sale in another Member State. The environmental objectives pursued by the Hungarian tax were questionable at best.

In Case C-402/09,[97] the Court recalls that Article 110 T.F.E.U. obligates each Member State to select and adapt taxes on motor vehicles in a way that does not have the effect of favouring the sale of domestic second-hand vehicles and thus discouraging the importation of similar second-hand vehicles. In this case, cars imported into Romania were taxed at the time of registration, while cars already on the Romanian market were exempt from such tax. Whether the registration tax pursued environmental objectives was irrelevant, since the system of registration was outright discriminatory. But this did not discourage Romania. In Case C-263/10,[98] a Romanian emergency ordinance had obliged a Romanian national to pay a new pollution tax when registering his vehicle in Romania. This tax was higher than the other pollution tax that was previously in force. The Court clarified that Article 110 T.F.E.U. does not prevent Member States from

[95] *See id.* ¶ 29.

[96] See Case C-290/05, Nádasdi and Németh, 2006 E.C.R. I-10115, ¶¶ 58-59: the Court accepts that Article 401 of the V.A.T. Directive confers on Member States the power to adopt indirect taxes like stamp duty and excise on the registration of vehicles within their territory.

[97] *See* Case C-402/09, Tatu v. Statul roman, 2011 E.C.R. I-02711.

[98] *See* Case C-263/10, Nisipeanu v. Direcția Generală a Finanțelor Publice Gorj, 2011 E.C.R. I-00097.

changing the rate or the basis of assessment of existing taxes. Moreover, the introduction of a new tax rate cannot be regarded as having a discriminatory effect between situations previously constituted and those which arose after the entry into force of the new rate. In this case, the Romanian ordinance had the effect of taxing imported used cars, while similar vehicles offered for sale on the domestic market were not taxed at all. According to the Court, Romania should have achieved its environmental protection objectives by taxing any similar vehicle that was put into circulation on its territory, regardless of its origin. Such a tax would be more effective, more consistent with the environmental objectives sought out to be achieved and would prevent all distortions within the national used car market.

Following Cases C-402/09 and C-263/10, Romania had introduced a new environmental tax on motor vehicles, this time it was called the "environmental stamp duty". A national entitled to a refund of the pollution tax he had previously paid when registering his vehicle in Romania was now obliged to pay this new environmental stamp duty (the refund was a direct result of the pollution taxes incompatibility with the Treaties). This obligation to pay subsisted even in the event that a Romanian court had ordered the restitution of the pollution tax previously paid. What Romania essentially did was create a new system which set-off the unduly paid "environmental" tax with a novel obligation to pay the environmental stamp duty. For the Grand Chamber,[99] such a system rendered ineffective the obligation to refund the pollution tax collected in violation of Union law. This was likely to perpetuate the discrimination for which Romania had already been condemned by the Court. According to the Grand Chamber, the reimbursement of an unduly collected environmental tax through a system of set-off with a new environmental tax (introduced after the repeal of the old tax) was illegal. Certain selective exemptions were debated in Case C-221/06. An Austrian law imposed a tax (*Altlastenbeitrag*) on the deposit of waste in a landfill, but exempted it when the waste originated from the securing or rehabilitation of contaminated sites listed in the country's official atlas. No foreign sites could be listed in the atlas, with the consequence that waste from abroad could not benefit from the exemption. According to Advocate General Sharpston, the differentiated tax treatment of the products concerned was based on an objective criterion, which was whether the waste was produced in the course of securing or cleaning up potentially contaminated sites listed in the Austrian contaminated sites register. However, the tax was structured in such a way as "to discourage the safeguarding and/or rehabilitation of sites in other Member States as compared with sites in Austria".[100] The Court recalled that Article 110(1) T.F.E.U. is

[99] *See* Case C-331/13, Nicula v. Administraţia Finanţelor Publice, ECLI:EU:C:2014:2285 (Oct. 15, 2014).
[100] *See* Case C-221/06, Stadtgemeinde Frohnleiten v. Bundesminister für Land-und Forstwirtschaft, 2007 E.C.R. I-09643.

violated when the taxation of the imported product and the taxation of the like domestic product are calculated differently, resulting, even if only in certain cases, in higher taxation of the imported product.[101] A tax such as the *Altlastenbeitrag*, which did not exempt the deposit of waste from rehabilitated sites outside Austria, was likely to hit an imported product harder than a domestic product. The Austrian Government's argument that it was difficult to identify rehabilitated contaminated sites in other Member States found no favour with the Court.[102]

At this stage of our analysis, we must therefore conclude that there is nothing to prevent Member States from adopting a system of environmental taxation that imposes a heavier burden on products that are harmful to the environment and that encourages consumers to change their habits towards more environmentally friendly purchases,[103] provided this system does not discriminate between local and imported similar products.

2.1.1.1.2.2. NON-SIMILAR PRODUCTS

As for the second Paragraph of Article 110 T.F.E.U., this applies when the local product and the imported product are not similar, but "in competition". In such a scenario, the Member State may apply different taxes so long as this difference in treatment does not constitute a form of indirect protection of local production. The stark contrast with Paragraph 1 is that differential taxation is *a priori* permitted in the case of competing products. It is the degree and overall effect of the differentiation which falls to be controlled by the Court. De Sadeleer notes that there is no single Court ruling applying Article 110(2) T.F.E.U. to an environmental tax.[104]

2.1.1.1.2.3. ARTICLES 30 AND 110 T.F.E.U.: WHAT DISTINGUISHES THEM?

Having examined the respective elements and scope of Articles 30 and 110 T.F.E.U., a question arises as to the difference in application between the charges prohibited by the two Articles.[105] The Court addressed this issue in Case C-213/96.[106] In Finland, a tax was applied to domestic electricity, the rate of which depended on the type of electricity

[101] *See id.* ¶ 49.
[102] *See id.* ¶ 70.
[103] *See* De Sadeleer, *supra* note 48, at 250-51.
[104] *See id.* at 254.
[105] See F. Martucci, Droit du marche interieur de l'Union europeenne (Presses Universitaires de France, 2021): while charges having an equivalent effect to customs tariffs are strictly prohibited even if neutral, internal taxes are, in principle, compatible with the internal market.
[106] *See* Case C-213/96, *supra* note 92.

production. There were three rates in total: one for nuclear electricity, one for hydroelectricity, and one for electricity from other sources. Electricity produced by generators with a capacity of less than two megawatts was exempt. As for imported electricity, Finland applied a single tax rate, regardless of its mode of production. While the Finnish legislator had set the tax rate with environmental considerations in mind, he failed to square the circle. However, the logical problem which arose was whether to tackle this under Article 30 or Article 110 T.F.E.U.

First, the Court noted that imported electricity and domestic electricity were taxed under the same tax regime. The tax was levied by the same authority, regardless of the origin of the electricity, and according to procedures governed by the general legislation on the taxation of products. The fact that the tax due by the importer was payable at the time of importation of the electricity did not mean that the tax was imposed on the product due to its crossing a border. Indeed, the Court clarified that the tax was levied at the moment of the product's commercialization because the production and importation of electricity amounted to the same thing, i.e., the arrival of the electricity on the national distribution network.[107] The Court declared the Finnish tax contrary to Article 110 T.F.E.U. stating that the fact that the origin of the goods was decisive for the amount of tax to be levied did not automatically lead to the application of Article 30 T.F.E.U.

The distinction between Articles 30 and 110 T.F.E.U. was again discussed in the Court's case law dealing with tax regimes that earmarked sums collected for use by environmental protection funds.[108] In Cases C-78-C-83/90,[109] sums collected through the imposition of a parafiscal charge on certain petroleum products were allocated to an Energy Savings Agency, which was to use them to finance measures to encourage energy savings or to encourage the rational use of insufficiently exploited energy resources. The question was whether the parafiscal charge was prohibited by Article 30 or Article 110 T.F.E.U. The Court answered that if the sums collected by a tax on petroleum products are allocated in such a way as to offset, fully, the burden borne by a national product when it is placed on the market, the tax will be contrary to Article 30 T.F.E.U. If, on the other hand, the sums collected from a tax on petroleum products are allocated in such a way as to offset only part of the burden on the national product, the tax will be evaluated under Article 110 T.F.E.U.[110]

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[107] *See id.* ¶ 25; see also Case C-305/17, FENS v. Slovak Rep., ECLI:EU:C:2018:986, ¶ 43 (Dec. 6, 2018), where the Court clarified that a tax on the use of the electricity network was caught by Article 30 T.F.E.U. when it consisted in two distinct charges which were levied upon importers and producers of electricity respectively.
[108] *See* Maitrot De La Motte, *supra* note 49, at 101.
[109] Joined Cases C-78-83/90, *supra* note 84, at ¶ 22.
[110] *See* Case C-517/04, Koornstra, 2006 E.C.R I-5015.

2.1.1.2. NON-TARIFF BARRIERS

Articles 34 to 36 T.F.E.U. deal with quantitative restrictions and measures having an equivalent effect to quantitative restrictions [hereinafter M.E.E.Q.R.s]. These provisions apply to physical, administrative and technical barriers that prevent the importation of products for other Member States. The case law in this area is voluminous, so a full description of it is beyond the scope of this work.

This being the case, a distinction must, at least, be made between internal taxation and M.E.E.Q.R.s. In Case C-47/88, the Court clarified that in the complete absence of local production that can be considered "similar to" or "in competition" with an imported product, Article 110 T.F.E.U. does not apply to a tax charge.[111] It completed its logical discourse by saying that, despite this absence, there was nothing to prevent such a tax burden from being assessed in the light of Article 34 T.F.E.U. So this begs the question: what does an environmental charge do that is not in the nature of an internal tax but in the nature of a M.E.E.Q.R. look like?

It seems that the Court has in mind particularly intense tax burdens with a rate so high, or a mode of collection so burdensome, that it would compromise the free movement of goods within the internal market.[112] While Article 110 T.F.E.U. does not impose any limit or sanction on the rate applied to an imported product, Article 34 T.F.E.U. could be invoked in the case of a rate that is so high that any marketing of the imported product on the market of a Member State is no longer possible in practice. This idea was initially taken up by Advocate General Jacobs in his opinion in Case C-383/01.[113] He concludes that it appears to be incompatible in principle with the objectives of the internal market for a Member State to tax certain imported goods to such an extent that the flow of intra-Community trade is significantly affected.[114] In this case, the Court concluded that a tax of 200% on the price of new cars registered in Denmark did not constitute a M.E.E.Q.R. since it did not affect the free movement of cars between Denmark and the other Member States.[115]

Several observations must be made at this stage. The words used by the Court are well nuanced. It states very clearly that the rate of the (environmental) tax must be such to jeopardise the free movement of the imported product: is a mere restriction or reduction in the flow of imports of a product sufficient for Article 34 T.F.E.U. to apply? On the face of it, what is needed is a rate that has such a deterrent effect that any access of the

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[111] Case C-47/88, Commission v. Denmark, 1990 E.C.R. I-04509.
[112] *Id.* ¶¶ 12-13.
[113] Case C-383/01, De Danske Bilimportører v. Skatteministeriet, 2006 E.C.R. I-04945.
[114] Opinion of Advocate General Jacobs in Case C-383/01, E.C.R. I-6065, ¶ 75 (Feb. 27, 2003).
[115] Case C-383/01, *supra* note 113, at ¶ 42.

product to the market of the importing member state will be rendered illusory. In other words, the tax rate must be such as to prohibit consumers from purchasing the product. Simply rendering its price less attractive will not suffice. De Sadeleer also notes that most eco-taxes act as incentives rather than disincentives; they encourage consumers to change their behaviour by lowering the costs of certain products considered less harmful to the environment.[116] It is, therefore, difficult to see how Article 34 T.F.E.U. can apply to an ecotax that, instead of hindering the marketing of an environmentally harmful product, facilitates the sale of a less harmful product. However, a recent judgement by the Grand Chamber may throw fresh light on the question of charges and M.E.E.Q.R.s. Indeed, that Court condemned Germany for imposing an infrastructural charge that mainly affected owners of vehicles registered in other Member States, even though the charge amounted to about 100 euros per year. Such a fee was found to hinder market access for products from other Member States and was considered a M.E.E.Q.R.[117]

We can close the debate on non-tariff barriers to trade created by certain ecotaxes by citing a very peculiar case which came before the Court. In Case C-13/96, the Belgian Federal Government introduced an ecotax on disposable articles. For purposes of better monitoring, all containers or products subject to the ecotax had to bear a distinctive mark indicating the amount of environmental tax payable on the product upon its release on the market. The Court considered that the national measure laying down the obligation to affix such a distinctive mark constituted a technical regulation.[118] (This is within what is now Directive (EU) 2015/1535 on the notification of technical regulations to the Commission).[119] It therefore had to be notified to the Commission prior to its adoption and failure to do so would oblige the national court to disapply it.

[116] De Sadeleer, *supra* note 48, at 250.
[117] *See* Case C-591/17, Austria v. Germany, ECLI:EU:C:2019:504, ¶ 127 (June 20, 2019).
[118] Case C-13/96, Bic Benelux SA v. Belgian State, 1997 E.C.R I-01753, ¶ 26.
[119] Directive 2015/1535, of the European Parliament and of the Council of 9 September 2015 laying down a procedure for the provision of information in the field of technical regulations and of rules on Information Society services, art. 5, 2015 O.J. (L241) 1.

2.1.2. FREE MOVEMENT OF SERVICES

Article 110 T.F.E.U. only protects goods, and its scope does not extend to services.[120] But Article 56 T.F.E.U. enshrines the freedom to provide services as a fundamental freedom and this article has had (albeit rarely) some impact on the design of environmental tax measures.

In one case, the Court ruled that a Belgian municipal tax on antennas violated Article 56 T.F.E.U. This tax was intended to reduce the number of antennas within a municipality and preserve the quality of the environment in the area. However, the Court ruled that the tax constituted an obstacle to the reception of television broadcasts because it hit service providers (broadcasters) established in other Member States more heavily,[121] and was also disproportionate, since it went beyond what was necessary to control the proliferation of antennas. The Court suggested that the municipality could have instead adopted regulatory requirements concerning the size of the antennas, and the location and manner of their placement.[122]

This case demonstrates two things. First, an environmental tax which impacts the activities of local and foreign service providers in equal degree would have been accepted by the Court as a legitimate measure restricting the freedom to provide services.[123] Secondly, the use of tax tools to regulate the provision of certain services could be considered a risky choice because of their cumbersome nature. Of course, much will depend on the base and rate of the tax, but the Court seems to have indicated a preference for "milder" regulatory tools.

In a similar manner, the Court has ruled that a tax exclusively levied on natural and legal persons, having their domicile outside the territory of Sardinia, for each stopover made by their aircraft and pleasure boats, was an obstacle to the free provision of services. Such a tax could not be logically justified on the basis of environmental protection, since aeroplanes and boats pollute independently of the tax residency of their operators.[124] A more coherent approach would have been to do away, entirely, with the tax residency criteria and simply tax the presence of aircraft and pleasure boats once they entered the particular locality.

[120] Maitrot De La Motte, *supra* note 49, at 110-11.
[121] *See* Case C-17/00, De Coster, 2001 E.C.R. I-9445, ¶ 31.
[122] *Id.* ¶ 38.
[123] *See* Joined Cases C-544-545/03, Mobistar et Belgacom Mobile, 2005 E.C.R. I-07723, ¶ 29, 31.
[124] *See* Case C-169/08, Presidente del Consiglio dei Ministri v. Regione Sardegna, 2009 E.C.R. I-10821, ¶ 44.

2.2. THE COMPATIBILITY OF ENVIRONMENTAL TAXES WITH SECONDARY LEGISLATION

In the first Paragraph of this Section (Paragraph 2.1.), we saw how the fundamental freedoms of the internal market can affect the design of environmental taxes. In this second Paragraph, we deal with the principal acts of secondary legislation knowing that the principles contained in Articles 30, 34 and 110 T.F.E.U. apply only in the absence of a total harmonisation of internal market rules.[125] It is therefore essential for the readers to familiarise themselves with the regulations and directives that govern certain aspects of indirect taxation within the Union. They should do so bearing in mind that a Member State wishing to introduce an environmental tax must also comply with the provisions of these legislative acts. In the realm of indirect taxation, the Union has adopted, among others, acts harmonising V.A.T. (Subparagraph 2.2.1.) and excise duties on energy products and electricity (Subparagraph 2.2.2.). It is also in the process of adopting a proposal for a regulation on a carbon border adjustment mechanism (Subparagraph 2.2.3.).

2.2.1 V.A.T. DIRECTIVE

The V.A.T. Directive establishes the common system of value added tax within the European Union.[126] V.A.T. is a general consumption tax which is imposed, in principle, on supplies of goods and services made by a taxable person.[127] It is always assessed strictly on the price of the goods and services sold (excise taxes being calculated according to the quantity/volume of goods and services sold).[128] V.A.T. rates cannot be set unilaterally by Member States.

The Commission had initially considered introducing a system of V.A.T. rates that integrate environmental considerations.[129] The economic consulting firm, Copenhagen Economics, had published a report evaluating the effects of such a measure to reduce greenhouse gases.[130] According to the report, a reduced V.A.T. rate is nothing more than a subsidy.[131] Another report published by the Directorate General for

[125] *See* Case C-305/17, *supra* note 81, ¶ 22.
[126] Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, 2006 O.J. (L347) 1 [consolidated version as of 1 July 2022].
[127] Lamensch et al., *supra* note 73, at 58.
[128] *Id.*
[129] *Id.* at 268.
[130] *Id.* at 270.
[131] *Id.* at 271.

Taxation and Customs Union (DG TAXUD)[132] shows that a reduced V.A.T. rate on green energy consumption could have an incentivising effect on consumers. Yet, such a rate, even if capable of helping consumers convert their energy consumption patterns, would probably have no effect on total energy consumption.[133] Another problem created by a reduced V.A.T. rate is that the subsidy granted via the reduced rate is often offset by an excise tax imposed on the same energy product. These contradictions tend to occur when policy instruments are adopted or amended in a fragmented manner without proper evaluation of the already existing tax framework.

The current V.A.T. Directive allows Member States to apply one or two reduced rates exclusively to supplies of goods and services falling within the categories listed in Annex III.[134] Annex III does not contain any criterion authorising the application of a reduced rate on the basis of the intrinsic characteristics of goods and services sold, or of their mode of production or distribution. Member States are simply not permitted to derogate from the provisions of the Directive for environmental reasons.[135] In fact, according to an Italian study, no country in the Union applies a V.A.T. rate regime that is based on the sole objective of fighting climate change and biodiversity loss.[136]

In its special provisions on the application of reduced rates, the V.A.T. Directive allows Member States, after consulting the V.A.T. Committee, to apply a reduced rate to supplies of natural gas, electricity or district heating.[137] But the application of such a reduced rate must nevertheless respect the principle of tax neutrality. This principle prevents similar goods, which are in competition with each other, from being treated differently from the point of view of V.A.T.[138] It does not matter whether they are designed, produced, or distributed differently. Goods or services are similar when they have similar properties and meet the same consumer needs, based on a criterion of comparability of use, and when any existing differences do not significantly influence the decision of the average consumer to use one or another of the said goods or services.[139] If the application of different V.A.T. rates on two similar products or services is likely to affect consumer choice, this would indicate a violation of the principle of fiscal neutrality.[140] This principle of V.A.T. neutrality bears a close resemblance to the

[132] *Final Report of the Center for Social and Economic Research on a study on the economic effects of the current VAT rates structure,* TAXUD/2012/DE/323 (Oct. 17, 2013).
[133] *Id.* at 31-33.
[134] Council Directive 2006/112/EC, *supra* note 126, at art. 98.
[135] Case C-161/14, Commission v. United Kingdom, ECLI:EU:C:2015:355, ¶¶ 30-31 (June 4, 2015).
[136] Di Pietro, *supra* note 18, at 83-85.
[137] Council Directive 2006/112/EC, *supra* note 126, at art. 102.
[138] *See* Case C-515/20, B AG v. Finanzamt A, ECLI:EU:C:2022:73, ¶ 42 (Feb. 3, 2022).
[139] *Id.* ¶ 44.
[140] *Id.* ¶ 45.

idea, advocated by some, that laws should be technologically neutral and avoid having any bearing on the choice which consumers make when deciding whether to purchase similar goods fulfilling the same functions. In a radical proposal, authors Traversa and Timmermans advocate instead for a V.A.T. system based on the life cycle assessment of the product or service, thus accounting for the impacts (across the value chain) of an activity or good on matters such as the environment, global warming, soil erosion, ocean acidification, ecotoxicity, etc. . .[141] It is not hard to see that such a system, if adopted, will require a complete revision of our current understanding of technological neutrality.

Finally, some recent developments on V.A.T. rates are of note. In 2021, the Commission declared that an agreement was reached in Council to revise the V.A.T. Directive by inserting new products and services deemed less harmful to the environment into Annex III.[142] This insertion converges with the Commission's goal of achieving a European green transition. On 5 April 2022, the Council adopted Directive (EU) 2022/542 which brought about the following major changes:[143]

- As of 1 January 2030, Member States shall no longer apply reduced rates or exemptions with deductibility of V.A.T. paid at the preceding stage on fossil fuels and other goods with a similar impact on greenhouse gas emissions, such as peat and firewood. Reduced rates or exemptions with deductibility of V.A.T. paid at the preceding stage on chemical pesticides and chemical fertilisers shall equally cease to apply, but this time from 1 January 2032;

- Furthermore, the following changes have been made to Annex III:

1. The supply and installation of solar panels on and adjacent to private dwellings, housing and public and other buildings used for activities in the public interest may benefit from a reduced rate of V.A.T.;

2. The supply of bicycles, including electric bicycles, and their repair, as well as the supply of services relating to the transport of passengers may benefit from a reduced rate of V.A.T.;

3. The supply of electricity, district heating and district cooling, and biogas produced from renewable materials listed in Directive (EU) 2018/2001 of the European

[141] Edoardo Traversa & Benoît Timmermans, *Value-Added Tax (VAT) and Sustainability in the European Union: A Radical Proposal Design Issues, Legal Aspects, and Policy Alternatives*, 49 INTERTAX 871, 876-78 (2021).

[142] European Commission Press Release QANDA/21/6609, Questions and Answers: Agreement on new rules governing VAT rates (Dec. 7, 2021).

[143] Council Directive 2022/542 of April 5, 2022, amending Directives 2006/112/EC and 2020/285 as regards rates of value added tax, 2022 O.J. (L 107).

Parliament and the Council on renewable energy sources may benefit from a reduced rate of V.A.T.;

4. Natural gas and wood used as firewood may benefit from a reduced rate of V.A.T. up until 1 January 2030;

5. The supply and installation of highly efficient low emissions heating systems that respect European regulations may benefit from a reduced rate of V.A.T.

2.2.2. ENERGY TAX DIRECTIVE

In 1992, the Commission presented a proposal to the Council for a directive obliging Member States to introduce a tax on carbon dioxide emissions and energy consumption.[144] The proposal was not adopted due to a lack of consensus among Member States in the Council.[145] In a 2001 paper,[146] the Commission declared that a lack of harmonisation in this sector could lead to confusion, since it was still possible for Member States to create several taxes with different bases and rates. Such a situation could undermine the proper functioning of the internal market, creating distortions in competition and in the prices of energy products.

Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity was adopted on 27 October 2003.[147] In its second premise, the Directive states that the absence of Community provisions imposing a minimum level of taxation on electricity and energy products other than mineral oils could be detrimental to the proper functioning of the internal market. The aim of the Directive is therefore to set a minimum level of taxation at Community level for energy products such as electricity, natural gas, and coal.[148] Having ratified the Kyoto Protocol, the Union wanted to use the taxation of energy products as an additional tool to achieve its objectives.[149] However, the Directive does not bring about a total harmonisation of the field, leaving Member States free to define and implement policies adapted to their national contexts.[150]

Article 1 of the Directive provides that Member States shall tax energy products and electricity in accordance with the Directive. The following are considered to be energy products among others: vegetable oils used as fuel or motor fuel, hydrocarbons, methanol

[144] *Proposal for Council Directive introducing a tax on carbon dioxide and energy,* COM (92) 226 final (June 2, 1992).
[145] Lamensch et al., *supra* note 73, at 267.
[146] *Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, Tax policy in the European Union - Priorities for the years ahead*, at 8-9, COM (2001) 260 final (July 14, 2021).
[147] Council Directive 2003/96, *supra* note 55.
[148] *Id.* at preamble 4.
[149] *Id.* at preamble 7.
[150] *Id.* at preamble 9.

which is not of synthetic origin and where it is intended for use as fuel, and electricity falling within C.N. code 2716.

When intended for use, offered for sale, or used as motor fuel or heating fuel, energy products other than those for which a level of taxation is specified in the Directive shall be taxed according to their use, at the rate applied to the equivalent fuel or heating fuel. The Directive does not apply to the taxation of certain activities, such as mineralogical processes or the dual use of energy products.[151]

With respect to the levels of taxation of energy products, Article 4(1) of the Directive provides that Member States may not impose rates below the minimum levels envisaged by the Directive. "Level of taxation" means the total amount of indirect taxes (excluding V.A.T.) levied, calculated directly or indirectly on the quantity of energy products and electricity at the time of release for consumption. Member States are free, in principle, to adopt differentiated rates of taxation, but only in the following cases and provided they respect the minimum levels of taxation laid down in the Directive:

- where the differentiated rates are directly related to the quality of the product

- where the differential rates are dependent on quantitative levels of consumption of electricity and energy products for heating,

- for the following uses: local public passenger transport (including cabs), waste collection, the armed forces and public administration, disabled persons, ambulances, between business and non-business consumption of fuels and electricity.

The different rates are mainly found in Article 7 of the Directive and vary according to the nature of the energy product. A distinction is drawn between commercial and non-commercial use of electricity in Article 10(1), which refers directly to Table C of Annex I. Above the minimum levels applied to electricity, Member States are free to determine the applicable tax base, provided they respect Directive (EU) 2020/262 (which replaced Directive 92/12/EEC on excise duties).

[151] *Id.* at art. 2(4).

Article 14 of the Directive sets out the mandatory exemptions. The following are exempt from tax across the Union:

- energy products and electricity used to generate electricity and electricity used to maintain the ability to generate electricity;[152]

- energy products supplied for use as fuel for air navigation other than private pleasure craft;

- energy products supplied for use as fuel for navigation in Community waters (including fishing), other than on board private pleasure craft, and electricity generated on board vessels.

In the case of air and sea transport, Member States may limit the scope of the exemptions to international and intra-community transport, and may even conclude bilateral agreements between themselves suspending these exemptions. In both cases, Member States may apply a level of taxation lower than the minimum level set by the Directive. It is important to note that any conditions adopted by Member States to ensure the implementation of mandatory exemptions must be proportionate.[153]

Articles 15 and 16 of the Directive contain a list of optional exemptions that Member States may adopt in their environmental policy. For example, Member States may apply total or partial exemptions or reductions in the level of taxation:

- to taxable products used in pilot projects for the technological development of less polluting products, or in the case of fuels from renewable resources;

- to electricity: of solar, wind, wave, tidal, or geothermal origin; of hydraulic origin produced in hydroelectric installations; produced from biomass or products derived from biomass; produced from methane emitted abandoned coal mines; or produced from fuel cells;

- energy products and electricity used for the transportation of people and goods by rail, metro, tram and trolley bus;

In Article 16, Member States may apply an exemption or a reduced rate to energy products that consist of or contain certain other specific products (such as

[152] *Id.* at art. 14(1)(a): to protect the environment, Member States may tax these products without having to respect the minimum rates of taxation.

[153] *See* Case C-355/14, Polihim-SS v. Nachalnik, ECLI:EU:C:2016:403, ¶ 59 (Jun. 2, 2016).

biofuel or biomass). Through these exemptions and reduced rates, Directive 2003/96/EC seeks to promote the use of energy products that are less polluting for the environment.

As to the chargeable event, this is governed by Article 6(1) of Framework Directive (EU) 2020/262, which provides that energy products shall be subject to excise duty either at the time of their production, including, where appropriate, extraction, in the territory of the Union, or at the time of their importation into the territory of the Union. In parallel, Article 21 of Directive 2003/96/EC provides that the energy tax for products for which no minimum rate is set in Annex I will be due at the time they are intended to be used, offered for sale, or used as motor fuel or heating fuel.

According to Article 6(2) of Framework Directive (EU) 2020/262, excise duty becomes chargeable at the time of release for consumption and in the Member State where the release for consumption takes place. For electricity and natural gas, there are specific chargeability rules contained in Article 21(5) of Directive 2003/96/EC, i.e., excise duty on these products becomes chargeable at the time of their supply by the distributor or redistributor. Where the release for consumption takes place in a Member State where the distributor or redistributor is not established, the tax applied in the Member State where the supply is made shall be chargeable to a consignee which must be registered in the Member State of supply. The tax is in any event levied and collected in accordance with the procedures laid down by each Member State.

In the final provisions of Directive 2003/96/EC, Article 25 provides that Member States shall inform the Commission of the levels of taxation they apply to energy products and electricity on 1. January of each year, as well as following any changes to their national legislation. In addition, Member States shall also inform the Commission of the measures they take with regard to: (i) differentiated rates; (ii) limitations on the scope of exemptions applicable to air and sea transport; (iii) total or partial exemptions under Article 15; and (iv) reduced rates in favour of energy-intensive firms and firms pursuing environmental protection objectives. Naturally, any tax measure constituting state aid must be notified to the Commission under Article 108 T.F.E.U.

The Directive's overall appraisal has not been satisfactory, as the Commission notes that it contributes only to a very limited extent to the environmental objectives of the Union.[154] In its current state, the Directive raises issues of incoherency with current climate and energy efficiency objectives since: (i) it taxes less carbon-intensive fuels in the same way as their fossil equivalent; (ii) it *de facto* favours fossil fuel use, allowing Member States to grant exemptions and reductions to these fuels, especially when used

[154] Proposal for a revised Energy Taxation Directive, *supra* note 43, at 8.

in energy intensive industries; and (iii) it is no longer creating a viable floor for taxation and the exemptions and reductions it permits have fragmented the internal market.[155]

It simply does not go far enough as it sets minimum tax rates too low, does not distinguish between renewable and carbon-intensive electricity sources, and does not consider the environmental performance of biofuels which are being disadvantaged due to taxation based on rates expressed per litre.[156] Moreover, the total exemption of aviation fuel (kerosene) has attracted the ire of environmental campaigners across Europe and it is doubtful whether such an exemption will survive the next round of environmental reforms.[157] The directive must therefore be revised to accommodate the latest technological advances and the Union's revised objectives since its adoption.

2.2.3. C.B.A.M. PROPOSAL

The current Commission proposal for a C.B.A.M. regulation merits brief mention in this paper.[158] In its "Fit for 55" package, the Commission describes C.B.A.M. as a climate action instrument that protects the integrity of the E.U. and global climate policy by reducing global greenhouse gas emissions.[159] It will be gradually introduced for a few selected products, ensuring that the same carbon price is paid by domestic and imported products, since non-discrimination is a requisite of W.T.O. rules.[160] According to the current compromise text of the C.B.A.M. proposal, the mechanism will apply to cement, electricity, fertilizers, iron and steel, aluminium, and hydrogen.[161] The C.B.A.M. Regulation is only effective if it is backed up by amendments to, among others, the Energy Taxation Directive, the Renewable Energy Directive and the European Union Emission Trading System [hereinafter E.U.-E.T.S.] Directive which all aim at steeper emission reductions to achieve the 2050 goal set by the Commission.[162]

This Regulation is crucial to maintain the coherence of the Union's environmental policy on the external plane, through the prevention of carbon leakage with a view of achieving the objectives of the Paris Agreement. The idea of a C.B.A.M. is

[155] *Id.* at 2-3.
[156] *Id.* at 8.
[157] *See* Thierry Vigoureux, *Aviation : l'Europe peut-elle imposer une taxe sur le kérosène ? [Aviation: can Europe impose a tax on kerosene?]* (Fr.), LE POINT (May 5, 2019, 8:58 AM), https://www.lepoint.fr/economie/aviation-l-europe-peut-elle-imposer-une-taxe-sur-le-kerosene-15-05-2019-2312633_28.php#1.
[158] CBAM Proposal, *supra* note 60.
[159] Commission Communication Fit for 55, *supra* note 42, at 12.
[160] *Id.*
[161] Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism (CBAM) – Compromise text, Annex I, 2022 2021/0214(COD).
[162] Commission Communication Fit for 55, *supra* note 42, at 6, 9.

to internalise the greenhouse gas emissions that are linked to the consumption of products imported from third countries. The mechanism is based on a system of declarations made by "declarants" that import any of the goods listed in Annex I into the Union, and all declarants must seek authorization before importing those goods.[163] Since the instrument used is a regulation, the C.B.A.M. will become immediately applicable in all Member States if and once adopted (even if a transitional period is envisaged that will run from 1 October 2023 and 31 December 2025 during which only a reporting obligation will apply).[164]

In its proposal, the Commission has decided in favour of a C.B.A.M. that is intrinsically linked to the E.U.-E.T.S. and not to a general carbon tax.[165] Indeed, the mechanism covers the same emissions as those regulated by the E.T.S.: carbon dioxide, nitrous oxide and perfluorocarbons.[166] One of the biggest issues of the proposal will be the determination of the volume of emissions that will be taken into account to define the applicable carbon price: will the mechanism take into account the emissions produced only during the production of the product, or will it cover all the emissions produced during the life cycle of the product?[167] Unfortunately, it seems that the Commission had initially opted in favour of the first solution[168] and the effect of this choice on international trade remains to be seen. However, the latest compromise text indicates that C.B.A.M. will also apply to indirect emissions, except in the case of products that benefit from financial measures to compensate for indirect emissions costs.[169] According to Pirlot, the mechanism as envisaged will reduce carbon leakage, but not eliminate it.[170]

Since the C.B.A.M. Regulation's legal basis is Article 192(1) T.F.E.U. it is not perceived by the Commission as a fiscal measure requiring unanimity for its adoption. However, there is a tendency in public debate to see C.B.A.M. as a tax on imports from third countries.[171] This does not change the fact that the text of the Regulation is intimately tied with the E.U.-E.T.S. regime. For instance, the price of C.B.A.M. certificates shall be the average of the closing prices of the E.U.-E.T.S. allowances on the common

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[163] CBAM Proposal, *supra* note 60, at art. 4-6.
[164] *Id.* at art. 36.
[165] *See* Alice Pirlot, *Carbon Border Adjustment Measures: A Straightforward Multi-Purpose Climate Change Instrument?*, 34 J. ENV'T L. 25, 38 (2022).
[166] CBAM Proposal, *supra* note 60, at Annex I.
[167] Pirlot, *supra* note 165, at 39.
[168] CBAM Proposal, *supra* note 60, at Preamble 17.
[169] CBAM – Compromise text, *supra* note 161, at Annex IA.
[170] Pirlot, *supra* note 165, at 47.
[171] *See* G. Budo, What's in a name? The New European Commission Proposal for a Carbon Border Adjustment Mechanism 51-55 (2022) (M.A. thesis, College of Europe).

auction platform for each week.[172] Also, C.B.A.M. certificates that are to be surrendered in such a manner as to reflect the extent to which E.U.-E.T.S. allowances are allocated free of charge to installations producing the goods listed in Annex I within the Union.[173]

2.3. ENVIRONMENTAL TAX INCENTIVES UNDER THE UNION'S STATE AID REGIME

As seen throughout Section 2 of the paper, a tension exists between the Member States' will to define their own tax systems and their obligation to respect the Treaty Articles.[174] To a certain extent, one of the aims of Union law is to strike down fiscal obstacles that can undermine the functioning of the internal market. In this context, one of the Articles which takes centre stage is Article 107 T.F.E.U., which prohibits all financial aid to undertakings which distorts competition on the market.[175] In this sense, Member States have limited their tax sovereignty by allowing the Commission to control the financial aid they grant to undertakings on their territory.

For the sake of brevity, this Paragraph of the paper will not delve into the special rules relating to "support schemes" which Member States may apply to promote the use of renewable energy on their territory. However, it is good to note that Directive (EU) 2018/2001 on the promotion of renewable energy sources allows Member States to apply "tax exemptions or reductions or tax refunds" to reach the Union's emission targets.[176] Such support schemes shall "shall provide incentives for the integration of electricity from renewable sources in the electricity market in a market-based and market-responsive way, while avoiding unnecessary distortions of electricity markets as well as taking into account possible system integration costs and grid stability".[177]

In a similar manner, and as we have seen in the previous Paragraph, the Energy Taxation Directive both allows and obliges Member States to grant a wide variety of reductions and exemptions on energy products and electricity. However, tax advantages granted in accordance with the Energy Taxation Directive (as it currently stands) do not necessarily need to pursue the Union's emission targets.

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[172] CBAM – Compromise text, *supra* note 161, at art. 21(1).
[173] *Id.* at art. 31.
[174] *See* J. Munier, La fiscalite environnementale et les aides d'Etat 7 (Editions universitaires europeennes ed., 2018).
[175] *See* I. Papadamaki, Les aides d'Etat de nature fiscal de l'Union europeenne 29 (Emile Bruylant ed., 2018).
[176] Directive 2018/2001, of the European Parliament and of the Council of 11 December 2018 on the Promotion of the use of Energy from Renewable Sources (recast), art 2(5), 2001 O.J. (L 328).
[177] *Id.* at art 4(2).

For the purposes of this Paragraph, however, it is worth noting that while Union secondary legislation (such as the Renewable Energy Directive and the Energy Taxation Directive) may specifically allow Member States to grant tax benefits to promote the use of cleaner energy (or to achieve different goals altogether), any such measures must conform with Article 107(1) T.F.E.U. This is a logical conclusion drawn from the constitutional principle that secondary legislation, and any measures adopted by Member States in virtue of it, must be compatible with provisions of primary legislation. The articulation between secondary legislation and primary legislation is evidenced, for instance, by the fact that aid in the form of reductions in environmental taxes granted under the Energy Taxation Directive must in principle fulfil the requirements of Article 107(3)(c) T.F.E.U., but may qualify for an automatic exemption under the General Block Exemption Regulation, provided that the provisions of Article 44 of that Regulation are fulfilled.[178]

In sum, should Member States grant tax benefits to fight climate change and environmental degradation by inducing a shift towards a circular economy,[179] then they must notify their decision to the Commission. The Commission will then consider whether the tax advantage granted constitutes aid within the meaning of Article 107(1) T.F.E.U. (Subparagraph 2.2.1.). If so, it must verify whether the tax advantage is compatible with the internal market, in accordance with paragraph 3(c) of the same Article (Subparagraph 2.2.2.). In this final Paragraph, we will therefore see how environmental tax incentives are treated under the Treaty provisions on state aid.

2.3.1. MATERIAL SELECTIVITY OF TAX ADVANTAGES PURSUING ENVIRONMENTAL OBJECTIVES

Article 107(1) T.F.E.U. prohibits "any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods". As we shall see, aid which takes the form of a selective environmental tax incentive will be caught by the general wording of Article 107(1) T.F.E.U. According to established case law, four conditions must be met for a tax benefit to be prohibited by this Article[180]:

1. there must be an intervention by the State or through state resources;
2. the intervention must be liable to affect trade between Member States;

[178] Council Directive 2003/96, *supra* note 55, at 6(5)(e).
[179] C.E.E.A.G., *supra* note 15, ¶¶ 1-4.
[180] Case C-431/07, Bouygues et Bouygues Télécom v Commission, 2009 E.C.R. I-2665, ¶ 102.

3. it must confer an advantage on the recipient;

4. it must distort or threaten to distort competition.

To guide our discussion, we would like to give a brief description of these conditions. With respect to the first condition, it should be noted that the Court has always adopted a broad notion of the criterion of imputability of aid to the State.[181] Thus, if an advantage causes a burden on the public finances, which may take the form of less revenue being generated, this advantage will be qualified as aid.[182] All tax reductions and exemptions and tax deferrals are therefore likely to be considered as aid.[183] Since tax advantages constitute a renunciation by a Member State of its own tax resources, this first condition is almost always met when a Member State offers tax advantages to firms on account of their less polluting activities.

The second condition is presumed to be met when the selectivity criterion of the fourth condition is also met.[184] The third condition, interpreted very broadly by the Court, is met when the recipient's economic position has improved as a consequence of the tax break, or when the recipient's economic position would have deteriorated had it not been for the tax advantage.[185]

Our discussion of Article 107(1) T.F.E.U. will therefore focus solely on *the fourth condition*, called the selectivity test, because much of the debate centering on the legality of environmental tax incentives depend on whether they can be classified as selective or not. According to the Court's case law, aid measures that are general in nature cannot be considered selective. For instance, under the latest Temporary Crisis Framework for State Aid following the Russian invasion of Ukraine, measures targeting commercial energy consumers do not constitute aid, provided they are of a general nature and take the form of general reductions in taxes or a reduced rate for the supply of natural gas.[186]

Rather, a measure is selective when it favours "certain undertakings or the production of certain goods over others which are in a comparable factual situation with regard to the objective pursued by the given tax scheme", except where "such differentiation results from the nature or general scheme of the system of charges."[187] In the Court's jurisprudence, a tax measure is qualified as selective when it departs from the general

[181] Papadamaki, *supra* note 175, at 19-21.
[182] *Id.* at 21.
[183] *Id.*
[184] Munier, *supra* note 174, at 9.
[185] *Id.*
[186] Communication from the Commission, Temporary Crisis Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia, at ¶ 28, COM (2022) 426/01 final (Mar. 24, 2022).
[187] Case C-T-399/11, Banco Santander v Commission, ECLI:EU:T:2014:938, 33, 36 (Nov. 7, 2014).

cadre de référence or reference tax system existing within a particular geographical setting. In other words, a tax break which has the effect of excluding a particular activity from general provisions which would, in the absence of that exclusion, have charged that activity to tax, would be considered selective.[188] In this sense, aid in the fiscal sector possesses the characteristic of breaking with the principle recognized by all the tax systems of the Member States, namely, that of equality before taxes. As a consequence of this breach of equality, economic operators come to benefit from differentiated treatment in the eyes of the law.[189]

According to Advocate General Tizzano, where a tax system provides an exemption in favour of certain taxpayers, there is a breach of formal equality.[190] In such a scenario, it is the legislator itself who binds the discretionary power of the tax authorities to grant that relief.[191] But the mere fact that a tax measure provides for differential treatment is not sufficient for that measure to be classified as selective. The departure from formal equality must also be accompanied by a departure from material equality among operators.[192] This latter criterion requires us to find a comparator to see whether economic operators in a factually and legally similar situation are treated differently. If the situation between two operators is similar, Article 107(1) T.F.E.U. dictates that they must be treated identically.[193]

During the Commission's analysis of the selectivity of a tax measure, the definition of the fiscal frame of reference takes on a critical role. More particularly, in the case of environmental taxation, the question which arises is whether a tax scheme, specially conceived by the legislator to achieve a given environmental objective, should be considered as an autonomous reference tax system or simply a derogation from the pre-existing and generally applicable tax provisions of a Member State. On this point, the Court has stated that the environmental purpose of fiscal measures is not sufficient to prevent qualification of those measures as aid.[194] However, it has admitted that a

[188] Papadamaki, *supra* note 175, at 105.
[189] *Id.*
[190] Opinion of Advocate General Tizzano in Opinion of Advocate General Tizzano in Case C-393/04, Air Liquide Industries Belgium, E.C.R. I-5293, ¶ 70-71 (June 15, 2006).
[191] Papadamaki, *supra* note 175, at 113-14.
[192] *Id.* at 119.
[193] *Id.* at 124.
[194] Case C-T-210/02, British Aggregates Association v. Commission, ECLI:EU:T:2012:110, ¶ 52 (July 19, 2012). In joint Cases C-106/09 P and C-107/09 P, Commission and Kingdom of Spain v. Government of Gibraltar and United Kingdom of Great Britain and Northern Ireland, 2011 E.C.R. I-11113, ¶ 87; the Court recalled that Consolidated Version of the Treaty on the Functioning of the European Union art. 107(1) , May 9, 2008, 2008 O.J. (C 115) 47 does not distinguish between measures of State intervention by reference to their causes or their aims, but defines them solely in relation to their effects.

specific ecotax could act as a frame of reference when assessing whether certain exemptions from such a tax are selective.[195]

When assessing selectivity, a Member State may justify a measure granting differential tax treatment to undertakings if that measure falls within "the nature or general scheme" of the tax system it has created.[196] Differential treatment between operators may be particularly justified in light of the objectives and mechanisms serving as the founding principles of the system in question. For schemes involving ecotaxes, the environmental objectives of the system will be taken into account to determine whether derogations from the reference tax system pursue the stated objective in a coherent manner.[197] If they are found to do so, then the criterion of selectivity will not be met. This is one of the exceptional instances in the Court's analysis of the material selectivity of environmental taxes where the coherence of an incentive measure is assessed in light of the objective the Member State wishes to achieve by adopting the tax system being examined.[198]

For example, a British law exempting from tax aggregates extracted from certain materials considered less polluting could have been justified by the nature or general scheme of an aggregates tax had the exemption been extended to cover other aggregates having the same environmental impact as the exempted ones. The incoherent policy of the British Government in exempting certain aggregates and not others undermined the objective of a general ecotax on aggregates.[199] This case-law demonstrates that the Court is willing to consider as justified any exemptions or tax deductions inspired by the environmental impact of products or services, provided they extend to similar products and services whose mode of production has a similar impact on the environment. In similar fashion, the Court has held that granting tax rebates on natural gas and electric power taxes exclusively to businesses that produce tangible goods and not to business which provide services is an aid (selective advantage); the ecological considerations

[195] Case C-T-210/02, British Aggregates Association v. Commission, ECLI:EU:T:2012:110, ¶ 51 (July 19, 2012).

[196] Case C-75/97, Belgium v Commission (Maribel bis/ter), 1999 E.C.R. 3671, at ¶ 33-34.

[197] See Case C-T-210/02, British Aggregates Association v. Commission, ECLI:EU:T:2012:110, ¶ 84 (July 19, 2012), citing case C-88/03, Portugal v Commission, 2006 E.C.R. I-7115.

[198] *See* Case C-233/16, Asociación Nacional de Grandes Empresas de Distribución (ANGED) v. Generalitat de Catalunya, ECLI:EU:C:2018:280, (Apr. 26, 2018) – in this case a regional (proportional) tax on large commercial establishments (exceeding 2.500m2) was meant to compensate for the environmental harm caused by both their construction and their activities. The tax system exempted smaller commercial establishments but also establishments due to their category (notably, car showrooms, flower shops and shops selling furniture, sanitary ware, etc...). At Paragraphs 53-55, the Court held that although there was a difference in treatment between large and small establishments the treatment was justified in light of the tax's goal of protecting the environment. As for the derogation by category of establishment; the Court was more cautious and held, at Paragraph 67, that the exemption will not be selective as long as the national court finds that the activities carried out in the exempted establishments did not cause the same degree of environmental damage and urban deterioration as the taxed ones.

[199] Case C-T-210/02, British Aggregates Association v. Commission, ECLI:EU:T:2012:110, ¶ 89 (July 19, 2012).

underlying the national legislation could not justify treating the consumption of natural gas or electricity by undertakings supplying services differently than the consumption of such energy by undertakings manufacturing goods, since energy consumption by each of those sectors is equally damaging to the environment.[200] However, exempting public transport, rail freight and electricity generated from clean energy sources from a general tax on the non-domestic use of energy products can be justified on the basis of the objective of fighting climate change which such a tax system pursues.[201]

2.3.2. THE COMPATIBILITY OF ENVIRONMENTAL TAX ADVANTAGES WITH THE INTERNAL MARKET

Before moving on to discuss the detailed rules governing the compatibility of environmental tax advantages under Article 107(3) T.F.E.U. and the latest Commission guidelines for assessing compatibility under that provision, we must point out that these do not constitute the sole basis for assessing compatibility of such measures with the internal market. Very importantly, the Guidelines we are about to discuss must be read jointly with the revised General Block Exemption Regulation [hereinafter G.B.E.R.] since, according to the recent State aid scoreboards, some ninety-five percent of aid directed to the energy and environmental objectives of the E.U. falls within the scope of G.B.E.R.[202] G.B.E.R. is doubly important for our purposes since fiscal aid in the form of reductions and exemptions form part of the principal measures caught by G.B.E.R. Generally, fiscal aid shall be compatible with the internal market under G.B.E.R. (and exempted from the notification requirement under Article 108(3) T.F.E.U.) if it falls beneath the notification thresholds set out for each category of aid[203] and the aid fulfils certain generic transparency requirements[204] together with the more specific requirements applicable to each category of aid and set out in Chapter III. By contrast, with the method used for assessing environmental tax advantages under the relevant Commission Guidelines, aid which falls under G.B.E.R. is presumed to have an incentive effect.[205]

[200] Case C-143/99, Adria-Wien Pipeline v. Finanzlandesdirektion, 2001 E.C.R. I-8365, at ¶ 52.

[201] Commission Decision 2002/676, ¶ 37, 2002, O.J. (L 229) 15 (EC); mais au paragraph 47 l'exonération donnée aux produits énergétiques à double usage constituait une aide puisqu'elle entraînait des conséquences dommageables pour l'environnement [but in paragraph 47 the exemption given to dual-use energy products constituted an aid since it had harmful consequences for the environment].

[202] *See* Commission Regulation 651/2014, 2014 O.J. (L 187) (EU) ; L. Hancher (ed), Research Handbook on European State aid law 83 (Edward Elgar ed., 2021) (UK).

[203] Commission Regulation 651/2014, *supra* note 202, at art. 4.

[204] *Id.* at art 5.

[205] *Id.* at art 6.

Once identified, fiscal aid of an environmental nature which *does not* benefit from the general block exemption described above could nevertheless be considered to comply with the internal market under Article 107(3)(c) T.F.E.U.,[206] if it: facilitates the development of an economic activity (the positive condition), and does not adversely affect trading conditions to an extent contrary to the common interest (the negative condition).[207] According to the latest Commission guidelines on State aid for climate, environmental protection and energy, the following criteria must be met for environmental aid more generally to be declared compatible with the internal market:[208]

1. the measure must facilitate an economic activity by identifying the positive effects for society at large and its relevance for specific policies of the Union;
2. the measure must have an incentive effect;
3. the measure must not breach any other provisions of Union law;
4. state intervention must be necessary;
5. the measure must be appropriate;
6. the measure must be proportionate (limited to the minimum necessary to attain its objective) including cumulation;
7. the measure must be transparent;
8. the undue negative effects of the aid on competition and trade have to be avoided;
9. the positive and negative effects of the aid have to be weighed up.

An explanation of each of these criteria is beyond the scope of this paper. However, the criteria of appropriateness of the aid should be noted because it means that aid can only be granted in the absence of another instrument less distorting of competition which is likely to achieve the desired results.[209]

According to its new Guidelines, the Commission accepts that aid may take the form of a reduction in environmental taxes.[210] In this scenario, the Member State introduces a general environmental tax to internalise the external costs of environmentally harmful behaviour, but offers reductions to companies whose economic activities are put at risk

[206] *See* Case C-143/99, Adria-Wien Pipeline v. Finanzlandesdirektion, 2001 E.C.R. I-8365, ¶ 31.
[207] C.E.E.A.G., *supra* note 15, ¶ 8.
[208] *Id.* ¶¶ 20-22.
[209] *Id.* ¶ 39.
[210] *Id.* § 4.7.1.

because of this tax. The Commission considers that aid in the form of environmental tax reductions will be compatible with the internal market if the Member State demonstrates that:

1. the reductions are targeted at the undertakings most affected by the environmental tax or levy that would not be able to pursue their economic activities in a sustainable manner without the reduction; and
2. the level of environmental protection actually achieved by implementing the reductions is higher than the one that would be achieved without the implementation of these reductions.[211]

If the Member State grants tax aid in sectors where taxes are harmonised (e.g., under Directive 2003/96/EC), the Commission may adopt a simplified approach to assess the necessity and proportionality of the aid.[212] However, to benefit from such an approach the Member State must ensure that the beneficiaries of the aid pay, at least, the minimum level of taxation set by the applicable directive and that the beneficiaries are selected according to objective and transparent criteria.

Outside the realm of tax harmonisation, tax relief must, among other things, respect the two criteria of necessity and proportionality.[213] A tax break is necessary when its beneficiaries are selected on the basis of objective and transparent criteria when the environmental tax, absent any reduction, would lead to a significant increase in production costs. Such production costs are calculated as a proportion of the gross value added for each sector or category of beneficiaries, and when the significant increase in production costs cannot be passed on to customers without causing a significant reduction in sales volumes. In addition, the tax relief must meet the requirements set out in Section 3.2.1.1 of the Guidelines and deal with the necessity of the aid. According to this Section, the proposed aid measure must be "targeted towards a situation where it can bring about a material development that the market alone cannot deliver, for example by remedying market failures in relation to 'the projects or activities for which the aid is awarded'".

[211] *Id.* ¶ 295.
[212] *Id.* ¶¶ 297-300.
[213] *Id.* ¶¶ 301-309.

Tax relief is considered proportionate if, at least, one of the following conditions is met:[214]

1. each aid beneficiary pays at least twenty percent of the nominal amount of the environmental tax or parafiscal levy that would otherwise be applicable to that beneficiary in the absence of the reduction;

2. the tax or levy reduction does not exceed 100% of the national environmental tax or parafiscal levy, and is conditional on the conclusion of agreements between the Member State and the beneficiaries or associations of beneficiaries. And therewith, the beneficiaries or associations of beneficiaries commit themselves to achieve environmental protection objectives which have the same effect as if beneficiaries or associations of beneficiaries paid, at least, twenty percent of the national tax or levy. Such agreements or commitments may relate, among other things, to a reduction in energy consumption, a reduction in emissions and other pollutants, or any other environmental protection measure.

The second type of fiscal aid envisaged by the Commission Guidelines takes the form of more generic tax reductions.[215] In this scenario, the Member State provides an incentive for companies to engage in projects or activities (listed in Sections 4.2 to 4.6 of the Guidelines) that increase the level of environmental protection - by according general reductions from taxes which do not necessarily have an environmental objective or character. For these tax reductions, the Commission's assessment differs as the Member State must demonstrate the incentive effect of the aid measure; its proportionality; as well as the avoidance of undue effect on competition and trade. To prevent unintended negative effects on competition and trade, the Member State must grant the reduction under the same conditions to all eligible undertakings active in the same economic sector, and who are in the same or similar factual situation with regard to the aims and objectives of the aid measure. Finally, the Member State must ensure that aid remains necessary for the duration of schemes that run for more than three years and evaluate them, at least, every three years.[216]

[214] *Id.* ¶ 308.
[215] *Id.* § 4.7.2.
[216] *Id.* § 4.7.2.5.

CONCLUSIONS

Member States retain considerable power in the use of fiscal instruments to protect the environment. While a common understanding surrounding the functions of environmental taxes in Europe exists, we note that the treaties do not offer a very generous legal basis for the adoption of a European-wide environmental tax of general scope. This explains why the proposed C.B.A.M. Regulation's legal basis is Article 192(2) T.F.E.U. Nevertheless, Member States' power to tax will only be compatible with the fundamental freedoms set out in the treaties if it is used to achieve a legitimate environmental goal in a coherent manner. In this respect, the following conclusions can be drawn from this paper.

First, in almost every case we have studied, the Court has made it clear that Member States may not design their fiscal system so as to favour domestic products and services, and it matters little that in doing so they set out to achieve laudable environmental goals. To put it plainly, domestic products cannot be the main beneficiaries, or the "chosen winners", of an environmental tax measure.[217] That line of thought was crystallised in *Outokumpu Oy*. The Court has applied a similar idea in the State aid field, although arguably the criteria for discrimination are different. According to settled case law, the environmental purpose behind a fiscal measure will not prevent it from being classified as aid. Furthermore, since *British Aggregates*, the Court analyses the issue of selectivity of an environmental tax in relation to similar products having an equivalent or superior impact on the environment than the one actually benefiting from a tax advantage. In short, if the goal behind a fiscal measure is protection of the environment, then similar goods having similar impacts on the environment must be "penalised" in an identical manner. Therefore, there seems to be a universal theme running through the case law, namely that like products must be treated alike.

Secondly, the main distinction to be drawn between free movement law and State aid law is that, although both set out general prohibitions on discriminatory fiscal measures, the latter admits justification of selective aid. This contrasts with Article 110 T.F.E.U. which does not allow Member States to justify discriminatory environmental taxes between similar domestic and imported products. Indeed, State aid law in the environmental sphere is characterised by very complex guidelines, which have only very recently been updated, on the compatibility of environmental fiscal aid with the internal market. Those guidelines are a witness to the Commission's will to allow as much aid as necessary to industries where failures in the market act as a hindrance to the

[217] Maitrot De La Motte, *supra* note 49, at 123; *see* also Céline Viessant, *The Impact of European Union Law on French Environmental Taxation*, GESTION & FIN. PUB. 20, 24-25 (May 13, 2021).

achievement of the Union's environmental and climate targets. Very importantly, fiscal aid in the environmental domain must be limited to that which is strictly necessary to both correct existing market failures and achieve the desired results.

Finally, we have seen that initiatives on the part of the Union legislature have to some extent further restricted the policy choices open to Member States in the environmental tax field. A distinction can be drawn between the Energy Taxation Directive and the V.A.T. Directive. While the first instrument (in its current state) allows for sweeping reductions and exemptions to be adopted on energy products, the second does not contain any criterion authorising the application of a reduced rate on the basis of the intrinsic characteristics of goods and services sold, or of their mode of production or distribution. Within this context, two of the most noteworthy restrictions that derive from Union secondary law are the prohibition on the taxation of kerosene and the stringent framework imposed on Member States when deciding whether to apply reduced rates of V.A.T. to environmentally friendly activities. It is likely that changes will be made to these instruments in the very near future to bring them in line with the Union's green and just transition targets.

ANNEX I: EUROSTAT GRAPH ON MEMBER STATE REVENUE FROM ENVIRONMENTAL TAXES

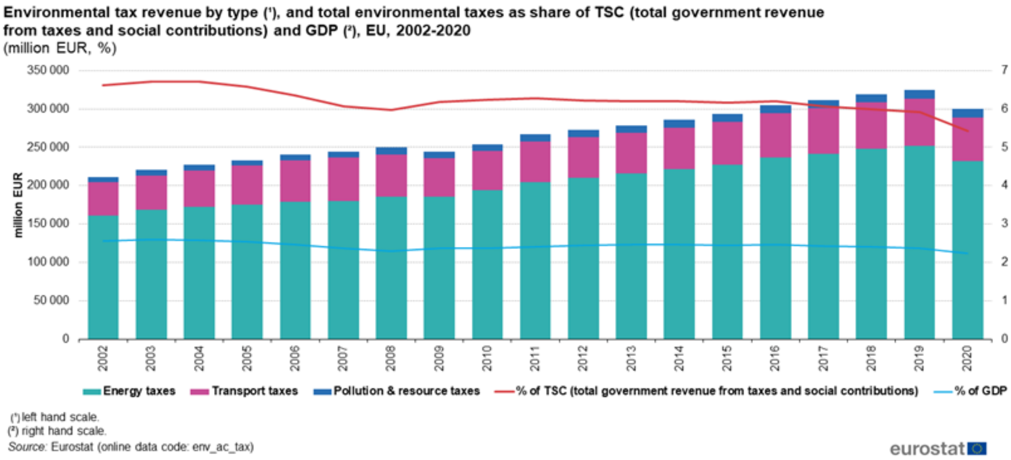

Figure 1: Annex I: Eurostat Graph on Member State Revenue from Environmental Taxes