

Taxation and Sustainable Development: a European Perspective

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Agenda – How to Tax our Way to Energy Justice?

- Setting the Scene
- Positive Intervention through Tax Incentives
- Negative Intervention – Correction of Wrong Behaviors
- Environmental Neutrality
- Conclusive Thoughts



Setting the Scene

- Energy is the ability to perform a work – for legal purposes it becomes relevant as the object of rights, relationships and transactions:
 - Natural energy: relevant for both public and private law
 - Human energy: corresponds to human behavior.
- Energy in a tax perspective:
 - Producers and distributors (R&D);
 - Use (businesses and private consumers)
 - General public (pollution)



Setting the Scene

- Energy sector went through major changes (liberalization, privatization, creation of an EU market, etc.) – Today:
 - Policy statements (UN; OECD; EU, etc.)
 - Ukrainian crisis
- Clean and affordable energy – where does the “tax factor” stands? How relevant is it?
- European perspective: legal principles of **horizontal equity** and **neutrality** were conceived in an economic perspective – is a different application possible?

Positive Intervention through Tax Incentives

- **R&D tax incentives** (as well as direct funding) is one of the keys to develop new techs – market failures:
 - ROI is uncertain - competitors may take advantage
 - Funding issues – SMEs
- They are seen as free-market instruments and can be of different types:
 - Expenditure: exemptions or credits
 - Profitability: Deductions (– e.g. patent box regimes)



Positive Intervention through Tax Incentives

- Regardless of criticism (e.g. BEPS) or the fact that developers may not be polluters.... How to restrict tax incentives to “green research” only?
 - What does “green” exactly mean? A too technical definition may be difficult to manage for both scholars and tax admin – a too general one would expose to abuse and difficult measurement of effectiveness
 - Selectivity..... Political vs legal issue
- Article 107 TFEU contains general prohibition of state aids



Positive Intervention through Tax Incentives

- Article 107 TFEU: balance between non-interference by the state and general interest of the community (key role for the EU Commission)
 - *Any aim ... through State resources... distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods*
 - Exceptions: social character, recovery from natural disasters, certain areas of the Union, etc., any category decided by the Council upon Commission's proposal
- EC Commission identified energy and environmental protection as priorities already in 2010 – recovery from the crisis (Europe 2020)

Positive Intervention through Tax Incentives

- In 2014, the EU Commission identified energy and environmental protection as permitted aids for the facilitation of development of certain economic activities (art. 107(3)(c) TFEU)
- Common idea that a *good tax* is a *fair tax*... here comes horizontal equity, which is intended in a strictly economic way, as non-disturbance of market dynamics and mechanisms:
 - Libertarian theory: equity is about competing at the best of own abilities
 - Liberal theory: equity is social circumstances not interfering with exploitation of natural talent

Positive Intervention through Tax Incentives

- No emphasis is put on the circumstance that environmental protection is one of the main goals of the Union under Articles 11 and 191 TFEU
- Provisional and conceptual solution: increase of the importance of environmental protection and elevation to constitutional rank with specific reference to the tax system



Negative Intervention – Correction of Wrong Behaviors

- Currently, there are several levies in force (often overlapping) – often they have little or nothing to do with environmental protection:
 - Disconnection from revenue generation and connection with the regulatory activity of the State
 - Either existing taxes or “green taxes”
- **Constitutional acknowledgment of regulatory function and consequent non-application of the ability-to-pay principle**



Negative Intervention – Correction of Wrong Behaviors

- The rationale is to make the polluter internalize the environmental costs of its activities
 - This economic principle evolved in a legal one: **polluter-pays principle**
- 1972 – Declaration of the UN Conference on the Human Environment (*Stockholm Declaration*): connection between environment protection and economic development
- Under the EU legal system this “appeared” in the late 80s (Single European Act 1987) and evolved in the following years



Negative Intervention – Correction of Wrong Behaviors

- Currently, TFEU:

- Art. 11: *environmental protection requirements must be integrated into the definition and implementation of the Union's policies and activities, in particular with a view to promoting sustainable development;*
- Art. 191: connection between human health and environment; and statement that environmental policies *shall be based on the precautionary principle and on the principles that preventive action should be taken, that environmental damage should as a priority be rectified at source and that the polluter should pay;*



Negative Intervention – Correction of Wrong Behaviors

- Expression of the **regulatory function of the tax system** rather than funding of the budget
 - Often this results in the double taxation of certain items – which may be problematic under constitutional principles and therefore needs a solid legal basis
- Ability-to-pay is based on the concept of equity:
 - Utilitarian theory: those with a greater ability can contribute more, as to them additional wealth is worth less – equal sacrifice maximizing the welfare of members of society
 - Egalitarian theory: those with greater ability to contribute shall contribute more, as they would still remain with *enough* (increase aggregate welfare)



Negative Intervention – Correction of Wrong Behaviors

- Ability-to-pay can also be stated reversely: those with the same capacity should pay the same amount – **horizontal equity**
- Polluter-pays is widely based on a **legal fiction**: environmental protection is disconnected from revenue generated by green taxes – in order to be effective the levy shall be sufficiently high to change the behavior
- Moreover: once the damage is done, it may be irreparable – how to apply the polluter-pays principle? Can one still derogate the ability-to-pay?

Negative Intervention – Correction of Wrong Behaviors

- Elevation of environmental protection to the highest constitutional rank – specifically referred to taxation
 - Regulatory taxes should not be seen as an exception to revenue-generating taxes.... Autonomous legitimacy and non-application of any economic criteria
 - Two persons or entities are not in the same situation if they pollute differently – even if they have similar income, assets, wealth, etc.
- This would also mean the elevation of the polluter-pays principle, with the consequence that it should not be balanced with the horizontal equity and ability-to-pay
 - Excessive burden would be prevented under **proportionality**



Negative Intervention – Correction of Wrong Behaviors

- Garcia and Roch (2016) also advocate for the elevation to the constitutional level, but developing a partially different reasoning
 - Ability-to-pay and polluter-pays are not in contradiction, as they have different functions
 - Two different criteria for fairness: (i) redistribution, which depends on the ability to pay; or (ii) restorative effect.... But what about the measurement of outcomes?
- CJEU case *Transportes Jordi* establishes a standard:
 - Predetermined allocation of revenues to env. protection
 - Designed specifically to dissuade from polluting... (results?)



Environmental Neutrality

- Multi-stage consumption taxes are frequently based on the principle of neutrality
- VAT Directive explicitly states: “[...] *does not distort conditions for competition or hinder the free movement of goods and services*” – EU was established as a **common (free-)market** after WWII
- Three main pillars of neutrality:
 - Businesses shall not be charged, only consumption
 - No obstacle / distortion of the Single Market
 - Equal treatment / horizontal equity (CJEU in *Marks & Spencer*)



Environmental Neutrality

- Outcome of the “**economic view**” is that products are **similar and therefore in competition if they are so for consumers**
- CJEU, *Commission v France* [2001]: on the exclusion from deduct the VAT on diesel fuel – judges rejected the environmental argument brought by the French government
- CJEU, *Commission v United Kingdom* [2015]: on the reduced rates for energy-saving materials – environmental or energy policy objectives cannot be considered as being of social interest

Environmental Neutrality

- Unless environmental protection is explicitly provided for, revenue objectives and competition always prevail
- In addition to the elevation at constitutional rank of environmental protection with regard to taxes: **environmental neutrality principle**
 - This would imply changes in both the pillars of equal treatment and no distortion – the non chargeability of business would remain unchanged
 - Break the current link between similarity and (economic) neutrality – reduced rates and differentiated treatment for polluters

Environmental Neutrality

- VAT can undergo a “greening process”, but would not become an environmental tax
- VAT rate structure is influential for the decisions of consumers seeking to reduce their expenditures
- Proposals to link the VAT rate to CEI ratios (*carbon emission intensity*) / LCA (*life cycle assessment*) – carbon labeling mechanisms exist already
- All these solutions are subject to criticism in the light of the regressive effect of VAT and should be coordinated with existing items (such as EU ETS)

Conclusive Thoughts

- Climate change and the need to rely on clean and affordable energy are “purely” global challenges
- Taxation can play a role but it is a domestic instrument
- Coordination and political will is the keys to face these challenges

