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Designing environmental taxes to promote
biofuels from a State aid perspective
The impact of the Energy Taxation Directive on
assessing selectivity of the Swedish and Finnish energy
taxation systems

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Preface

This thesis marks the end of my time at Lund University. In writing this thesis I owe my special thanks particularly to three persons.

First of all I would like to thank Hanna Eklinder whom I was lucky to share office with during my internship at the Swedish Ministry for Foreign Affairs. Hanna was the one who encouraged me to write about State aid and biofuels and who was of great help during the initial stages of writing this thesis. For that I am very grateful.

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Stockholm, 26 May 2019
Torbjörn Schiebe

Summary

To comply with the Paris Agreement and to deal with the threat caused by climate change, the Swedish Parliament has set ambitious targets for greenhouse gas (GHG) reductions. For the transport sector, which accounts for 30 % of total GHG emissions, a milestone target is to reduce GHG emission by 70 % by 2030 compared to 2010 (2030 goal). Biofuels is in this respect considered decisive to reach the 2030 goal. To promote its use, Sweden, like many other Member States, has primarily relied on tax reliefs, which in Sweden has come in the form of exemptions from its energy tax and CO₂ tax, which together form the Swedish energy taxation system.

Member States' freedom to design environmental taxes to promote for example biofuels is however limited by Union objectives relating to the functioning of the internal market. More specifically, Article 107(1) TFEU prohibit, with certain exemptions, State aid "favouring certain undertakings or the production of certain goods", that is to say selective aid. Moreover, energy taxes, such as the Swedish energy and CO₂ taxes – as well as the Finnish equivalents – are considered harmonised excise duties under the Energy Taxation Directive (ETD). The ETD provides in this respect for motor fuels to be taxed on the basis of volume rather than environmental performance, which means that tax reliefs in favour of biofuels will derogate from the main rule in the ETD and therefore face the risk of constituting selective aid. Assessing tax selectivity is however, as is well known, far from a straightforward task. This is illustrated not the least by the fact that the Commission has continuously considered that the Swedish tax exemptions entails selective aid in favour of biofuel producers, while seemingly accepting that this is not the case in relation to the Finnish energy taxation system, which, although not formally promoting biofuels, nevertheless grants tax reliefs to biofuels under its CO₂ tax scheme due to biofuels lower emissions in a life-cycle perspective.

Against this background, this thesis deals with the issue of selectivity in the context of the Swedish and Finnish energy taxation systems. The thesis analyses the impact of the ETD on the three-step test developed in the CJEU's case-law to assess selectivity of tax measures, reviewing to this end whether the Swedish and Finnish energy taxation systems are in fact selective. The thesis shows that the internal logic of the ETD, ie taxing all motor fuels on the basis of volume rather than environmental performance, becomes of paramount importance in this analysis as only objectives internal to a tax system may be relied on for the purpose of the selectivity analysis. As both the Swedish and the Finnish energy taxation systems (despite the Finnish being treated otherwise) in fact appears to be selective – due to the internal logic of ETD – the thesis concludes that it is imperative that the ETD is revised to enable environmental taxes that is properly oriented towards environmental objectives to not constitute selective aid.

Abbreviations

CJEU	Court of Justice of the European Union
CPC	The Swedish Climate Policy Council
EEAG	Environmental and Energy Aid Guidelines
ESR	Effort Sharing Regulation
ETD	Energy Taxation Directive
EU	European Union
EU ETS	European Union emissions trading system
GC	General Court
GBER	General Block Exemption Regulation
IPCC	The Intergovernmental Panel on Climate Change
Prop	Swedish government bill (preparatory works)
RP	Finnish government bill (preparatory works)
RED	Renewable Energy Directive
RED II	Renewable Energy Directive (recast)
SOU	Swedish government's official reports (preparatory works)
TEU	Treaty of the European Union
TFEU	Treaty of the Functioning of the European Union

1 Introduction

1.1 Biofuels and State aid issues – the Swedish experience

Climate change is, arguably, the greatest challenge facing humanity to date. To limit this threat, scientific modelling states that the world should aim towards reaching net-zero global anthropogenic emissions of carbon dioxide (CO₂) around 2050. In line with this the Swedish parliament has set an emissions target where Sweden shall reach net-zero emissions by 2045 at the latest.¹ To reach this goal, ambitious milestone targets are needed. For the transport sector, which accounts for almost 30 % of total greenhouse gas (GHG) emissions in Sweden, the Swedish parliament has set a milestone target of reducing GHG emissions by at least 70 % by 2030, compared to the year 2010 (2030 goal).² While this target presupposes an extensive substitution away from fossil fuel driven vehicles, a fair share of the emission reductions will have to be done with today's transport fleet by substituting fossil fuels for biofuels. Access to biofuels is thus considered crucial for Sweden's ability to reach its 2030 goal.³ Biofuels are moreover promoted at European Union ('EU' or 'Union') level in the Renewable Energy Directive⁴ (RED). However, as biofuels are more expensive to produce than fossil fuels they need support of some sort in order to be competitive. To this end, tax reliefs are considered an effective tool, and has also been the main tool together with biofuel supply/quota obligations⁵, to promote biofuels in the EU.⁶ In line with this, the Swedish practice has therefore been to exempt biofuels from its CO₂ tax and energy tax.

Member States' freedom to design environmental taxes to promote for example biofuels is however limited by Union objectives relating to the functioning of the internal market. Most notable in this respect are the State aid rules in Articles 107 and 108 of the Treaty of the Functioning of the European Union⁷ (TFEU). According to Article 107(1) TFEU Member States are prohibited, with certain exemptions, from granting State aid "favouring *certain* undertakings or the production of *certain* goods", that is to say, selective aid. Following Article 108(3) TFEU Member States are required to notify any plan to grant State aid to the European Commission (Commission), which has the possibility to approve the aid if it is considered necessary for reasons of, for example, environmental protection. This assessment is done, primarily, subject to the Guidelines on Environmental and Energy Aid⁸ ('environmental aid guidelines' or 'EEAG'). In this regard, the Commission has continuously held that the Swedish tax exemptions constitute selective aid in favour of biofuel producers. The Swedish government

¹ Prop 2016/17:146 Ett klimatpolitiskt ramverk för Sverige, p 25.

² Ibid, p 35; SOU 2016:47 En klimat- och luftvårdsstrategi för Sverige, del 1, p 87.

³ Prop 2016/17:146 (n 1), p 36.

⁴ Directive 2009/28/EC of the European Parliament and the Council of 23 April 2009 on the promotion of the use of energy from renewable sources, as amended by Directive (EU) 2015/1513 [2009] OJ L140/16.

⁵ An obligation on fuel suppliers to supply a certain amount of biofuels on the market by blending biofuels into diesel and petrol.

⁶ Jose M Cansino and Others, 'Promotion of biofuel consumption in the transport sector: An EU-27 perspective' (2012) 16 Renewable and Sustainable Energy Reviews 6013, p 6014-6016.

⁷ Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C 326/01.

⁸ Commission, 'Guidelines on State aid for environmental protection and energy 2014-2020' [2014] OJ C200/1 as corrected [2016] OJ C290/11.

has therefore had to notify its tax exemptions under Article 108(3) for approval under the EEAG (and its predecessors).⁹

Even if the Swedish tax exemptions has continuously been approved under the EEAG and previous guidelines, such approvals has significant drawbacks in terms of foreseeability for operators and investors. First of all, aid schemes approved under the EEAG are time-limited. Secondly, as aid will only be approved if considered necessary, aid may only be given to the extent it compensates for the fact that the product benefiting from the aid is more costly to produce (so-called prohibition on overcompensation).¹⁰ Equally, aid to biofuels in the form of tax reliefs is under the current EEAG, which entered into force in 2014, as a general rule, not considered necessary if biofuels are already guaranteed an outlet on the market via a supply obligation (which generally do not constitute State aid).¹¹ Lastly, the EEAG contains a restriction on approving aid to food-based biofuels after 2020.¹² This restriction is aimed at tampering growing international concern for so-called indirect land-use change (ILUC) effects,¹³ which can lead to reduced GHG savings due to indirect emissions. Yet this restriction is viewed as very problematic from a Swedish perspective as it jeopardizes effective support to certain Swedish food-based biofuels with very high CO₂ reduction compared to fossil fuels.¹⁴

All in all, these restrictions have led to the conclusion that finding a non-aid solution to support biofuels is paramount in order to reach the 2030 goal.¹⁵ However, doing so has proved far from easy. Although the situation has partly been resolved with the introduction, from 1 July 2018, of the emissions reduction obligation scheme¹⁶ (a type of quota obligation under which fuel suppliers are required to reduce their GHG emissions by blending biofuels into diesel and petrol), this also meant that low-blended biofuels subject to the emissions reduction obligation is no longer eligible for tax exemptions.¹⁷ While this is problematic to the extent that the incentive effects are not as strong as would both measures have been in place, more problematic is the fact that a long-term solution is yet to be found for high-blended and pure biofuels as those were not deemed suitable to include in the emission reduction obligation.¹⁸ In this respect

⁹ See eg Commission Decision N 480/2002 – Sweden: Punktskattelättnad för koldioxidneutrala drivmedel, C (2003) 4071 final; Commission Decision SA 43301 – Sweden: Tax exemptions and tax reductions for liquid biofuels, C (2015) 9344 final.

¹⁰ EEAG (n 8), paras 69 and 70.

¹¹ Ibid, para 114.

¹² Ibid, paras 113 and 121.

¹³ Indirect land use change may occur where agricultural land previously destined for food and feed markets are diverted to biofuel production, leading to other non-agricultural land with potentially very high carbon stock (rainforest being the prime example) being diverted into agricultural land to satisfy the demand for food and feedstock (see Commission, ‘A policy framework for climate and energy in the period from 2020 to 2030’ (Communication) COM (2014) 15 final, p 6f).

¹⁴ See Svante Lundquist, ‘Naturskyddsföreningens remissvar på Kommissionens förslag om ändring av Bränslekvalitetsdirektivet och Förnybarhetsdirektivet, avseende indirekt markanvändning’ (Stockholm, 21 February 2013), p 3-5.

¹⁵ See prop 2017/18:1 Budgetproposition för 2018, p 344.

¹⁶ Swedish Act (2017:1201) on reduction of greenhouse gas emissions by blending of biofuels into petrol and diesel fuels.

¹⁷ Prop 2017/18:1 (n 15), p 344.

¹⁸ See ibid, p 380 and 385.

the uncertainties are reinforced by the fact that the current Commission Decision¹⁹ approving the tax exemptions for those biofuels expires at the end of 2020, which coincides with the end date for when the EEAG stipulates that no new aid to food-based biofuels can be guaranteed.

From the point of view of climate policy, the importance of finding a long-term solution for these biofuels cannot be understated. Indeed, according to the Faculty of Engineering, LTH, at Lund University, high-blended and pure biofuels are crucial for the possibility to reach a fossil free vehicle fleet in Sweden.²⁰ The urgency of the matter was moreover confirmed by the first report issued (in March 2019) by the newly established Swedish Climate Policy Council (CPC), a scientific body whose mission is to determine whether or not the Swedish government's policies is compatible with set climate targets.²¹ According to the CPC, the possibility to reach set targets depends heavily on the progress in the transport sector, where biofuels will continue to play a major role going forward. Progress is, however, too slow, and under the current framework emission reductions is only expected to reach about 35 % by 2030. The CPC point in this respect to insufficient instruments to incentive increased production of domestic biofuels, and observes that the continued uncertainty for investors with regard to high-blended and pure biofuels constitute a significant obstacle to domestic production.²²

In summary, the described situation has given rise, among stakeholders and across the board of Swedish political life, to what cannot be described as anything but great dissatisfaction. The author of a consultancy report provided within the framework of the Swedish Cross-Party Committee on Environmental Objectives, stated for example that the State aid rules has caused "serious problems for Swedish climate policy".²³ The current government has moreover made it a political objective to work for a reformation of the State aid rules so that they "contribute, rather than counteract, the transition to a carbon free society and the implementation of the Paris Agreement."²⁴

1.2 Problem formulation, aim and research questions

While the picture outlined above can come across as, perhaps, one sided, it remains a fact that, with regard to biofuels, the problems caused by the State aid rules are perceived as significant. In this regard, one can get the impression that the main problem is the restrictions contained in the EEAG. However, one only ends up in the EEAG if a measure falls within the scope of Article 107(1) TFEU in the first place. That is to say, if the tax reliefs are considered selective.

¹⁹ Commission Decision SA.48069 – Sweden: Tax reductions for pure and high-blended biofuels, C (2017) 6169 final.

²⁰ Prop. 2017/18:1 (n 15), p 378.

²¹ See Prop. 2016/17:146 (n 1), p 41f.

²² Klimatpolitiska rådet, 'Klimatpolitiska rådets rapport 2019' (2019), p 10-13 and 72.

²³ Mikael Karlsson, 'Statsstöd i EU som möjlighet och hinder för svensk klimatpolitik' in SOU 2016:47 En klimat- och luftvårdsstrategi för Sverige, del 2, p 138.

²⁴ Avtal om sakpolitisk överenskommelse mellan Socialdemokraterna, Centerpartiet, Liberalerna och Miljöpartiet de gröna, punkt 34.

In other words, if the Swedish tax reliefs would *not* be considered selective, the problems described above would disappear.

As it turns out, the question of whether a tax measure is selective or not is far from straightforward. Indeed, while a tax that differentiates between fossil fuels and biofuels appears, on the one hand, clearly selective, it seems, on the other hand, completely reasonable to make such a differentiation if the very purpose of a tax is to differentiate between activities depending on their environmental performance.²⁵ The latter is also what the Swedish government has argued over the years, although unsuccessfully, when it has tried to get the Commission's acceptance for its CO₂ tax scheme as not entailing State aid.²⁶ Interestingly, the Commission, in contrast to that seems to have accepted that the Finnish energy taxation system does *not* involve State aid, despite differentiating between fossil fuels and biofuels in its CO₂ tax and energy tax.²⁷

At the heart of this discrepancy is the presence of the Energy Taxation Directive²⁸ (ETD), which harmonises taxation of energy products, such as motor fuels, in the EU. Under the ETD, motor fuels, including biofuels, are taxed on the basis of volume rather than energy content and CO₂ emissions, which means that applying favourable tax treatment to biofuels will, according to Article 16 of the ETD, constitute a derogation from the main rule in the directive.²⁹ Yet, exactly *how* the ETD impacts on the selectivity assessment in that regard is not entirely clear, which is illustrated by the different findings as to the selectivity of the Swedish and Finnish energy taxation systems. The purpose of this thesis is therefore to study how the ETD influences the selectivity assessment of the taxation of biofuels in the Swedish and Finnish energy taxation systems. To achieve this purpose, it is necessary, first, to investigate the selectivity criterion and how it is applied to tax measures, and particularly tax measures aimed at protecting the environment, and, second, whether that assessment is affected by the fact that the taxes under assessment are harmonised under the ETD. As a discussion and analysis of these research questions has more value if seen within the context of biofuels as a means to fight climate change, it is important, also, to investigate how biofuels are promoted and regulated in the EU.

²⁵ Cf Jérôme Monsenego, *Rätt på EU:s sätt – en ESO-rapport om EU-rättens inverkan på svensk skattelagstiftning* (Elanders Sverige AB 2019), p 92.

²⁶ Ministry of Finance, Sweden, 'Withdrawn non-aid notification in SA.36972, Annex 1. The General Swedish CO₂ taxation scheme, Annex 2. Application of energy tax for diesel and petrol and biomass fuels that replace such fuels' (25 October 2013).

²⁷ See RP 191/2018 rd Regeringens proposition till riksdagen med förslag till ändring av lagstiftningen om energibeskattnig, p 15.

²⁸ Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity [2003] OJ L283/51.

²⁹ Álvaro Antón Antón and Marta Villar Ezcurra, 'Inherent logic of EU energy taxes: towards a balance between market protection and environmental protection' in Larry Kreiser and Others (eds), *Environmental Taxation and Green Fiscal Reform: Theory and Impact* (EE 2014), p 59.

1.3 Delimitations

The central provisions of State aid law are, as stated, Articles 107 and 108 TFEU. As these provisions are drafted in a relatively general manner, a vast body of secondary legislation and soft law documents (such as the EEAG) has been adopted to specify the scope and application of these provisions. While the compatibility of aid measures for environmental protection, as stated above, are primarily assessed on the basis of the EEAG, it is actually Article 107(2) and (3) that gives the Commission authorisation to approve aid measures at all. However, as particularly Article 107(3) grants the Commission ample discretion in approving aids, the Commission has sought to limit its discretion and the possibility that it gets subject to political pressure by adopting a large number of guidelines (including the EEAG), which specify in detail how particular types of aid measures should be designed in order to be approved.³⁰ Moreover, to streamline the assessment of compatibility and avoid unnecessary administrative burdens, a General Block Exemption Regulation³¹ (GBER) has been adopted. The GBER declares aid fulfilling all its relevant conditions as automatically compatible with Article 107(2) and (3) and exempts such aid from the notification requirement in Article 108(3) TFEU.³² Furthermore, as aid under a certain threshold is not deemed to affect intra-EU trade and competition, which, as will be seen, are prerequisites for aid to fall within the scope of Article 107(1), the Commission has adopted a *de minimis* regulation.³³ As such *de minimis* aid is not deemed to fall within the scope of Article 107(1), it is henceforth also exempt from the notification requirement in Article 108(3).³⁴

As this thesis concern the question of the selectivity of tax reliefs, that is to say, whether a measure constitute aid at all under Article 107(1) TFEU, the above provisions and instruments, although of relevance when it comes to approving aid, will, in principle, not be discussed any further in this thesis.

1.4 Method and material

In order to answer the above research questions I will go on a two-fold mission. First of all I intend to establish what the law actually is; *de lege lata*. But since stopping there would do the topic injustice, I will also discuss to some extent what the law ought to be; *de lege ferenda*. With regard to *de lege lata*, a traditional legal dogmatic method will be used. The main purpose of that method is to establish what the law actually is by using the traditionally recognized sources of law.³⁵ In the Nordic legal tradition this generally means statutes, preparatory works,

³⁰ Kelyn Bacon, *European Union Law of State Aid* (3d edn OUP 2017), p 6.

³¹ Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty [2014] OJ L187/1.

³² Article 3 of the GBER (n 31).

³³ Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 107 TFEU to *de minimis* aid [2013] OJ L352/1.

³⁴ Article 3 of the *de minimis* Regulation (n 33).

³⁵ See Jan Kleineman, 'Rättsdogmatisk metod' in Fredric Korling and Mauro Zamboni, *Juridisk Metodlära* (Studentlitteratur 2014), p 26.

case-law and scholarly writings (doctrine). However, due to the internationalisation of the law, the sources of laws has been widened to include, not the least, Union law.³⁶ While both Swedish and Finnish statutes and preparatory works will be used when explaining and interpreting the Swedish and Finnish energy taxation systems, the core of this thesis concern EU law and in particular the rules on State aid. This thesis is therefore primarily concerned with establishing *de lege lata* on the basis of Union law legal sources.

In the Union legal order, the role of the Court of Justice of the European Union ('CJEU' or 'Court') is of particular importance as it is the principal interpreter of Union law.³⁷ This is not the least evident in relation to the State aid rules. Indeed, as the definition of State aid in Article 107(1) TFEU is formulated in general terms, its application has to a large extent been shaped by the case-law of the CJEU. The main investigation in this thesis will thus be based on an analysis of the case-law of the CJEU. However, also Commission decisions and legal doctrine are relevant in this regard. As to the former, it is important to emphasise the central role of the Commission in the area of State aid. Following Article 108 TFEU and the Procedural regulation³⁸, it is responsible to control the application of the State aid rules.³⁹ As mentioned above, this means that the Member States has to notify any new aid to the Commission,⁴⁰ which has been given exclusive competence to determine whether or not the aid is compatible with the internal market pursuant to Article 107(2) and (3) TFEU. Following Article 288 TFEU, the Commission's decisions are moreover legally binding. Such decisions may however be appealed to the Union courts.⁴¹ Commission decisions are therefore an important source of law when interpreting and applying the rules on State aid.⁴²

The Commission moreover issues notices and guidelines (such as the EEAG) that are a valuable source of law within the State aid field. With regard to the former, of particular importance is the Notice on the notion of State aid⁴³, which the Commission issued in 2016 to increase legal certainty on the application of Article 107(1) and contribute "to an easier, more transparent and more consistent application of this notion across the union".⁴⁴ These "soft law" documents are according to Article 288 TFEU not legally binding, but will according to the principles of equal treatment and legitimate expectations bind the Commission in its application *vis a vis* the Member States.⁴⁵ Member States' can therefore expect that the Commission complies with its

³⁶ Christer Sandgren, *Rättsvetenskap för uppsatsförfattare: Ämne, material, metod och argumentation* (2nd ed Nordsteds Juridik 2007), p 36-39.

³⁷ See Article 19 TEU; Jane Reichel, 'EU-rättslig metod' in Fredric Korling and Mauro Zamboni, *Juridisk Metodlära* (Studentlitteratur 2014), p 115.

³⁸ Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (codification) [2015] OJ L 248/9.

³⁹ Philipp Werner and Vincent Verouden (eds), *EU State Aid Control: Law and Economics* (Kluwer Law International 2017), p 14f.

⁴⁰ Article 108(3) TFEU; Article 2-4 of the Procedural Regulation (n 39).

⁴¹ See Articles 263 and 265 TFEU.

⁴² Paul Craig and Gráinne De Burca, *EU Law: Text, Cases, and Materials* (6h edn, OUP 2015), p 1130ff.

⁴³ Commission, 'Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU [2016] OJ C262/1

⁴⁴ *Ibid*, para 1.

⁴⁵ Herwig C H Hofmann and Claire Micheau (eds), *State Aid Law of the European Union* (OUP 2016), p 226.

issued soft law documents.⁴⁶ The CJEU has furthermore acknowledged its value as a point of reference.⁴⁷ The Commission's notices and guidelines may therefore have legal effect, despite its soft law character. While the EEAG, as stated above, will not, in principle, be dealt with in this thesis, frequent references will on the other hand be made to the Commission's Notice on the notion of State aid. References to other non-legal material, such as reports and Commission communications, where the Commission for example sets out its policy objectives, will also be made through this thesis.

1.5 Definitions relating to biofuels

As the world of biofuels may not be mainstream knowledge, it may be valuable to provide the reader with some definitions and clarifications before continuing with the substantive part of this thesis. Biofuels are liquid or gaseous fuels for transport produced from biomass.⁴⁸ Biomass, in turn, can be anything of biological origin, such as different crops, slaughterhouse or municipal waste, or residues from forestry (such as lignin, saw dust, cutter shavings, branches etc).⁴⁹ Common biofuels are biodiesel, ethanol and biogas. As mentioned above, biofuels can either be used for low-blending in petrol and diesel or be sold in high-blended or pure form (eg E85, ED95 and HVO100).

As different raw materials, feedstocks and production methods differ in their impact on the environment, so do biofuels. The benefit of biofuels, in terms of GHG emission savings compared to fossil fuels, therefore very much depends on how, where, and what raw material is used to produce the biofuel. This is why, as will be explained below, sustainability criteria has been attached to the EU's biofuels regime in the RED.

In the early stages of development, biofuels were generally produced from food or feed crops, such as sugar beets, maize or rapeseeds. These are the biofuels referred to as food-based biofuels above. Such biofuels are also generally referred to as first generation biofuels. As explained above, food-based biofuels, due to its considered ILUC effects, are not eligible for financial support after 2020 under the current EEAG. The intention is thus, from the Commission's perspective, that such biofuels should be gradually phased out to be replaced by more advanced biofuels.⁵⁰ Such advanced biofuels, also referred to as second and third generation biofuels, are biofuel produced primarily from waste and residues from for example the forest industry.⁵¹

⁴⁶ C-351/98 *Spain v Commission* EU:C:2002:530, para 53.

⁴⁷ C-310/99 *Italy v Commission* EU:C:2002:143, para 52.

⁴⁸ Article 2(i) of the RED (n 4).

⁴⁹ Article 2(e) of the RED (n 4).

⁵⁰ See COM (2014) 15 final (n 13), p 6f.

⁵¹ See Annex XI of the RED (n 4).

1.6 Disposition

As Member States' policy objectives relating to biofuels has to be seen in the context of the Union's overall climate policy framework, I will start by shortly presenting that framework. As part of that framework, the EU's policy on renewable energy, and particularly biofuels, will be outlined for, followed by a section on the two main support schemes (ie tax reliefs and supply obligations) used to promote biofuels in the EU. I will proceed, in chapter 3, with an introduction to State aid law, explaining the definition of State aid in Article 107(1) TFEU and how it is applied on tax measures. In that regard, the selectivity criterion will only shortly be explained. Instead, chapter 4 will be entirely devoted to the selectivity criterion as it is the most important, as well as complex, criterion in Article 107(1) when it comes to taxation. To that end, the three-step test developed in the Court's case-law to assess selectivity in tax matters will be explained and analysed, focusing particularly on the question of whether external policy objectives, such as environmental protection, may justify differential treatment between undertakings. Having done that, I will proceed in chapter five with explaining, first, the main features of the ETD and in particular its Article 16, and second, the Swedish and Finnish energy taxation systems. Finally, I will discuss and analyse the potential selective nature of the Swedish and Finnish energy taxation systems and the impact the ETD has on that assessment.

2 Promotion of biofuels in the EU

2.1 Introduction

As mentioned in the introductory chapter, Member States policy objectives relating to biofuels has to be seen in the wider context of the Union's climate policy framework. This chapter will therefore provide a brief overview of this framework, of which renewable energy, including biofuels, forms part. With regard to biofuels, the most important aspect in this respect are the sustainability criteria contained in the RED, which, inter alia, make financial support to biofuels dependent on fulfilment of these criteria. Moreover, as biofuels, as stated, are more costly to produce and therefore are dependent on support mechanisms of some sort, the two main support systems that has been deployed in the EU will lastly be provided for.

2.2 The Union's climate policy framework

Environmental protection is, according to Article 3 of the Treaty of the European Union⁵² (TEU), a declared objective of the EU. Since the Lisbon Treaty came into force in 2009, Article 191(1) TFEU further specify, inter alia, that the EU shall “promote measures at international level to deal with regional or worldwide environmental problems, and in particular combating climate change.” However, climate change has been on the (Union's) agenda prior to that as well. Already back in 1996, ahead of the Kyoto climate negotiations, the EU adopted the goal to work for a maximum increase in the global average temperature of 2°C above pre-industrial levels. As the 2°C goal subsequently was translated to mean that industrial nations need to reduce their GHG emissions with 80-95 % by 2050 compared to 1990 levels,⁵³ the European Council in 2009 set an objective to reduce emissions along that line.⁵⁴ The Paris Agreement, ratified by 185 parties, including the EU⁵⁵, has now made the 2°C goal (while pursuing efforts to limit warming to 1.5°C) into a legally binding target.⁵⁶ Following the urgency expressed by the Intergovernmental Panel on Climate Change (IPCC) in its 2018 Special Report on the impacts of global warming of 1.5°C above pre-industrial levels,⁵⁷ the Commission in the end of 2018 issued a Communication confirming Europe's long-term commitment to work towards achieving net-zero GHG emissions by 2050.⁵⁸

To reach its long term goal the EU has set milestone targets for 2020 and 2030. For 2020 the Europe 2020 strategy sets targets to reduce GHG emissions by at least 20 % compared to 1990

⁵² Consolidated version of the Treaty on the European Union [2012] OJ C 326/01.

⁵³ SOU 2016:47, part 1 (n 2), p 80.

⁵⁴ Presidency conclusions of the Brussels European Council (29/30 October 2009) 15265/1/09 REV 1, para 7.

⁵⁵ Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change [2016] OJ L282/1.

⁵⁶ Paris Agreement, Decision 1/CP.21, 29 January 2016, Doc. FCCCC/CP/2015/10.Add.1, Article 2(1)(a).

⁵⁷ See IPCC, 2018: Summary for Policymakers' in Panmao Zhai and Others (eds), *Global warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty* (World Meteorological Organization 2018).

⁵⁸ Commission, 'A Clean Planet for all – A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy' (Communication) COM (2018) 733 final, p 3-5.

levels, increase the share of renewable energy in final energy consumption by 20 %, and achieve a 20 % increase in energy efficiency (the so-called 20-20-20 targets).⁵⁹ For 2030 the European Council adopted, in anticipation of the Paris Conference, in October 2014, a 2030 framework for climate and energy policies. The 2030 framework sets new targets to the effect that by 2030, GHG emission has to be reduced by at least 40 %, the share of renewable energy has to be at least 32 % and energy efficiency has to be improved by at least 32.5 %.⁶⁰

To meet these targets, a range of legislative acts have been adopted. With regard to the overall goal of GHG emission savings, the EU emissions trading system (EU ETS)⁶¹ is the EU's key tool for cutting GHG emissions from large-scale facilities in the power and industry sectors (as well as the aviation sector).⁶² For sectors outside the EU ETS, the so-called non-trading sectors (eg transport and agriculture), Member States have taken on binding annual targets until 2020 for cutting emissions in these sectors under the Effort Sharing Decision.⁶³ To comply with the 2030 framework, new reduction targets for the period 2021-2030 for the non-EU ETS sectors was adopted in May 2018 in a new Effort Sharing Regulation⁶⁴ (ESR). While the transport sector accounts for almost 30 % of Union overall GHG emissions, it accounts for approximately 50 % of the emissions in the non-trading sector.⁶⁵ To this end, the Commission aligned the proposal for the ESR back in 2016 with a Communication for "A European Strategy for Low-Emission Mobility".⁶⁶ In this Communication, the Commission reiterates the ambition, first set out in a 2011 White Paper, of reducing, by 2050, GHG emissions from transport by at least 60 % compared to 1990 levels. The Communication furthermore identifies, as one of three priority areas for action, the need to speed up and support deployment of low-emission alternative energy for transport, such as advanced biofuels, electricity and renewable synthetic fuels.⁶⁷ However, there is no EU wide sector-specific emissions reduction target for transport to 2030, equal to the one set nationally by the Swedish Parliament.

With regard to renewable energy the Member States has taken on binding national targets under the RED.⁶⁸ These targets has been revised upwards in line with the 2030 framework in the new

⁵⁹ Commission, '20 20 by 2020 – Europe's climate change opportunity' (Communication) COM (2008) 30 final, p 2.

⁶⁰ European Council, minutes of the meeting 23-24 October 2014, document EUCO 169/14, p 1 and 5. The targets for renewables and energy efficiency were initially set at 27 %, but revised upwards in 2018.

⁶¹ 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 [2003] OJ L275/32.

⁶² Under the EU ETS, installations covered need to receive a permit to emit GHG, which subsequently can be traded within the system. See on this, Ludwig Krämer *EU Environmental Law* (8th edn, Sweet & Maxwell 2016), p 339ff.

⁶³ Decision No 406/2009/EC of the European Parliament and of the Council of 23 April 2009 on the effort of Member States to reduce their greenhouse gas emissions to meet the Community's greenhouse gas emissions reduction commitments up to 2020 [2009] OJ L140/136.

⁶⁴ Regulation (EU) 2018/842 of the European Parliament and of the Council of 30 May 2018 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement [2018] OJ L156/26.

⁶⁵ See prop 2016/17:146 (n 1), p 22.

⁶⁶ Commission, 'A European Strategy for Low-Emission Mobility' (Communication) COM (2016) 501 final.

⁶⁷ *Ibid*, p 2 and 4-6.

⁶⁸ See note 4 above.

Renewable Energy Directive⁶⁹ (RED II), which enters into force on 30 June 2021.⁷⁰ Apart from setting national targets for the share of renewable energy in gross final consumption, the RED sets targets for the share of renewables in transport as well as sustainability criteria relating to biofuels.

2.3 Targets on renewable energy – RED and RED II

The RED incorporates in Article 3(1) the target from the Europe 2020 strategy of at least 20 % share of energy from renewable sources in the EU's gross final consumption of energy in 2020. The overall goal has subsequently been translated into individual mandatory targets for each Member State, reflecting their different starting points and potentials; thus spanning from 10 % for Malta to 49 % for Sweden.⁷¹ The RED furthermore sets a target of 10 % for the share of renewable energy in transport to be achieved individually by all Member States by 2020.⁷² The choice of means to achieve the national targets are, in principle, left to the Member States.⁷³ As was stated in the introduction and as will be shown in the next section, Member States has in this regard primarily relied on two measures, namely tax reliefs or biofuel supply obligations.

To accommodate for the fact that increased production of biofuels may cause significant environmental and social problems – not the least illustrated by the expansion of palm oil plantations in South East Asia, which at least in part is driven by increased demand for biofuels – ⁷⁴ the RED sets out sustainability criteria in Article 17. These criteria has to be fulfilled in order for biofuels to be eligible for financial support and in order for such energy to count towards achievement of the national targets.⁷⁵ The sustainability criteria can, in essence, be divided into two parts: requirements on minimum GHG emission savings and restrictions on land-use.⁷⁶ With regard to the former, biofuels are considered sustainable only if use of these fuels result in reductions of GHG emissions, compared to fossil fuels, by at least 50 % or at least 60 % if the biofuel is produced in installations starting to operate after 5 October 2015.⁷⁷ The calculation of the GHG emission savings takes the whole production chain into account (so-called life cycle analysis); from cultivation of the biomass, including manufacturing of fertilisers, to consumption of the biofuel.⁷⁸ The calculation with regard to biofuels produced from waste or residues should, however, be made from the point of collection; thus

⁶⁹ Directive (EU) 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) [2018] OJ L328/82.

⁷⁰ For a short historical overview of EU policy on renewable energy, see Theodoros Iliopoulos, 'Dilemmas on the Way to a New Renewable Energy Directive' (2018) EEELR 210.

⁷¹ See recital 15 and Annex I of the RED (n 4).

⁷² Article 3(4) of the RED (n 4). The 10 % targets thus applies equally for all Member States (see recital 16).

⁷³ Iliopoulos (n 70), p 213; Krämer (n 62), p 347.

⁷⁴ See Álvaro Antón Antón, 'Energy Taxes and Promotion of Renewable Energy Sources (RES): Combination of Excise Reliefs and Supply obligations of RES Seen from the State Aid Perspective' in Marta Villar Ezcurra and Others (eds) *Energy Taxation, Environmental Protection and State Aids* (IBFD 2016), section 14.2; Agneta Carlsson and Others, *Biobränslen för en hållbar framtid – Utmaningar för ett 100 % förnybart energisystem i Sverige* (Naturskyddsföreningen 2014), p 20-22.

⁷⁵ Article 17(1) and recital 65 of the RED (n 4).

⁷⁶ Cf prop. 2017/18:1 (n 15), p 338.

⁷⁷ Article 17(2) of the RED (n 4).

⁷⁸ Article 17(2) second subparagraph and Article 19(1) of the RED (n 4).

incentivising the use of such biofuels.⁷⁹ As to the land-use criteria, it stipulates that the raw material used to produce the biofuel is not allowed to come from land with high biodiversity value (eg primary forest)⁸⁰ or land with a high carbon stock (eg wetlands).⁸¹ The land-use criteria is however not applicable on biofuels produced from waste and residues, other than agricultural, aquaculture, fisheries and forestry residues.⁸² To furthermore accommodate for the concerns of ILUC-effects of food-based biofuels mentioned in the introduction, a 2015 amendment of the RED introduced a 7 % cap on the amount of such biofuels that can count towards the 10 % target.⁸³

As to the calculation rules for the purpose of demonstrating compliance with the 10 % target, Article 3(4) provides for substantial enumeration of different renewable sources. Biofuels made from feedstock listed in Annex IX (eg municipal waste or residues from the forest industry) are thus worth twice its energy content (double-counting),⁸⁴ and renewable electricity when used to supply road vehicles is worth as much as five times its energy content.⁸⁵ Unsurprisingly, this system of enumerating the actual percentage of renewable energy, even though it is used to incentivise certain renewables, has been criticised as it in effect will allow Member States to comply with the target while actually not providing 10 % renewable energy in the transport sector.⁸⁶ From a communication and information perspective it must also be considered problematic as figures will be reported and communicated to the general public which are not based on reality. For example, in 2017 Sweden's share of renewable energy in transport was reported as 38.6 %, while the real value was approximately 20 % (excl. Rail). In 2017, Sweden was also the only Member State, together with Finland (18.8 %), that had already reached the 10 % target.⁸⁷ While several Member States are on track to meet the target, at least 8 Member States will face difficulties in reaching the target as they still have less than 5 % renewables in their transport energy mix.⁸⁸

As to the recast RED II, which as stated above, enters into force on 30 June 2021, it sets forth a paradigm change in that the renewable energy target of 32 % is binding on the EU as a whole and not individually for each Member State.⁸⁹ According to the Commission, the rationale for this change is to increase Member State flexibility to set national objectives on the basis of “their specific circumstances, energy mixes and capacities to produce renewable energy”.⁹⁰

⁷⁹ Annex V(c)(18) of the RED (n 4).

⁸⁰ Article 17(3) of the RED (n 4).

⁸¹ Article 17(4) of the RED (n 4).

⁸² Article 17(1) first subparagraph of the RED (n 4).

⁸³ See Recital 17 and Article 2(2)(iv) of Directive (EU) 2015/1513 of the European Parliament and of the Council of 9 September 2015 amending Directive 98/70/EC relating to the quality of petrol and diesel fuels and amending Directive 2009/28/EC on the promotion of the use of energy from renewable sources [2015] OJ L239/1.

⁸⁴ Article 3(4)(f) of the RED (n 4).

⁸⁵ Article 3(4)(c) of the RED (n 4).

⁸⁶ Cf Naturskyddsföreningen (2013) (n 14), p 7.

⁸⁷ Eurostat (22 February 2019) <<https://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20190222-1>> accessed 27 March 2019.

⁸⁸ Commission, ‘Renewable Energy Progress Report’ COM (2019) 225 final, p 6.

⁸⁹ Article 3(1) of the RED II (n 69); Iliopoulos (n 70), p 215.

⁹⁰ COM (2014) 15 final (n 13), p 6.

In relation to the transport sector, Articles 25-28 sets out a framework for “mainstreaming renewable energy in the transport sector”. To this end, Article 25(1) requires Member States to set obligations “on fuel suppliers to ensure that the share of renewable energy within the final consumption of energy in the transport sector is at least 14 % by 2030 (minimum share)”. Acknowledging, in recital 83, the lack of a stable policy framework in relation to renewable energy in the transport sector, this measure is intended to cure that uncertainty and “create a long-term perspective for investment in sustainable biofuels”.⁹¹ To incentivise the use and development of advanced biofuels, produced from feedstock listed in Part A of Annex IX (eg residues from forest and forest-based industries), Article 25(1) fourth subparagraph stipulate that such fuels, for the calculation of the minimum share, shall gradually increase from at least 0.2 % in 2022 to at least 3.5 % in 2030.⁹² Following Article 25(1) sixth subparagraph, Member States are given substantial freedom in terms of achieving the minimum share; referring, inter alia, to measures targeting volumes, energy content or GHG emissions. Despite the reference to fuel suppliers, the obligation in Article 25 therefore seems to be directed to the Member States and not the individual fuel suppliers.⁹³ Accordingly, Article 25 does not seem to differ much, in practice, from the 10 % sectoral target for transport prescribed for in the present RED.

With regard to food-based biofuels, RED II provides for the same 7 % cap as that contained in the RED.⁹⁴ However, RED II is also more restrictive in that 2020 operate as a base year from which the share of such fuels in the final consumption of energy may only increase by one percentage point.⁹⁵ While a further discussion on the adequacy of this is beyond the scope of this thesis,⁹⁶ suffice to say is that the position taken in RED II reflects the Commission’s view that such biofuels should be gradually phased out in favour of more advanced biofuels. As to the calculation rules (now in Article 27) they are in essence the same as those provided for in Article 3(4) of the RED. That is equally the case in terms of the sustainability criteria, which in RED II are contained in Article 29.

2.4 Main support systems to promote biofuels in the EU – tax reliefs and biofuel supply obligations

While the 10 % target in RED do not presuppose use of biofuels, that is in reality what most Member States has chosen to rely on.⁹⁷ However, as production costs for biofuels are higher than that of fossil fuels, support systems of some sort are needed to reach set targets. In that

⁹¹ See also Commission, ‘Proposal for a Directive of the European Parliament and of the Council on the promotion of the use of energy from renewable sources (recast)’ COM (2016) 767 final/2, p 11.

⁹² See recital 81, 83 and 85 of the RED II (n 69).

⁹³ Cf Ministry of Finance, Sweden, ‘Memo – legal arguments for a changed interpretation of EEAG 2014-2020 for aid after 2020 in light of the new RED II’ (11 January 2019), p 5.

⁹⁴ See Article 26(1) of the RED II (n 69).

⁹⁵ A Member State can thus only reach 7 % if its fuel mix already contained 6 % of such biofuels in 2020.

⁹⁶ Cf, in this regard, Ministry of Finance, Sweden (2019) (n 93).

⁹⁷ Antón Antón (n 74), section 14.1; COM (2019) 225 final (n 88), p 4.

regard Member States has, as already stated, primarily relied on tax reliefs and biofuel supply obligations.⁹⁸

With regard to tax reliefs, it was initially the main support measure to promote biofuels and indeed vital for its early development.⁹⁹ Its strength lies in that it is efficient, easy to implement and implies few market risks.¹⁰⁰ Moreover, for Member States like Sweden, which has a high pre-existing level of taxation on motor fuels, tax reliefs becomes the most effective way to create a generally applicable instrument that promotes both low-blended biofuels and high-blended and pure biofuels.¹⁰¹ However, as tax reliefs on biofuels may constitute State aid, such aid must, in that case, comply with the restrictions provided for in the EEAG. This inter alia mean, as stated in the introduction, that aid measures may only compensate for the additional production costs of biofuels (ie no overcompensation). Moreover, the ETD has incorporated the prohibition on overcompensation in its Article 16(3), which means that, regardless of a finding of State aid, biofuels are not allowed to be cheaper, at the pump, than its fossil counterpart. Tax relief as a policy tool will therefore, in itself, not encourage increased consumption of biofuels.¹⁰² Another drawback is that it implies public revenue losses, losses that will increase in line with increased biofuel consumption.¹⁰³

To overcome these problems, biofuel supply/quota obligations – whereby fuel suppliers are obliged to supply a fixed quota of biofuels in the transport fuel mix – has been increasingly used. The main advantage with supply obligations is that it is predicable. Both in terms of creating a long-term predicable framework for biofuel producers and suppliers, as biofuels will have a guaranteed outlet on the market, and in terms of reaching set biofuel targets. With regard to the former, a decisive factor is that supply obligations, as stated in the introduction, generally does not constitute State aid. Indeed, its character as non-aid was one of the main reasons why Finland back in 2007 decided to introduce a quota system to promote biofuels, instead of using tax reliefs.¹⁰⁴ This was, similarly, central to the Swedish government's decision to introduce the emission reduction obligation.¹⁰⁵ A drawback with target systems such as supply obligations is, however, that the market tend to adapt to the set quotas, which means that if targets are set too low there is a high risk that the full potential of biofuels is not exploited.¹⁰⁶ This risk is moreover elevated by the higher price of biofuels. If applied alone, an obligation on fuel suppliers to blend a certain quota of biofuels into diesel and petrol will inevitably result in higher fuel prices when fuel suppliers pass their increased costs on to consumers. To counteract

⁹⁸ Antón Antón (n 74), section 14.3; Cansino and Others (n 6), p 6014.

⁹⁹ Commission, 'Renewable Energy Progress Report' COM (2009) 192 final, p 7; Tobias Wiesenthal and Others, 'Biofuel support policies in Europe: Lessons learnt for the long way ahead' (2009) 13 Renewable and Sustainable Energy Reviews 789, p 794.

¹⁰⁰ Antón Antón (n 74), section 14.3.

¹⁰¹ See Antón Antón (n 74) section 14.3. See also prop 2009/10:41 Vissa punktskattefrågor med anledning av budgetpropositionen för 2010, p 115ff.

¹⁰² Antón Antón (n 74), section 14.3.

¹⁰³ Wiesenthal and Others (n 99), p 795.

¹⁰⁴ RP 231/2006 rd Regeringens proposition till Riksdagen med förslag till lag om främjande av användningen av biodrivmedel i trafiken, p 8.

¹⁰⁵ Prop 2017/18:1 (n 15), p 344.

¹⁰⁶ See Wiesenthal and Others (n 99), p 795.

rising fuel prices, Member States may therefore be reluctant to set targets too high,¹⁰⁷ or, as done by Sweden, decrease the tax levied on motor fuels in order to counteract increased prices at the pump.¹⁰⁸

As both instruments have drawbacks, several Member States started, during the early stages of development (approximately 2005-2013), to apply a combination of the two instruments, ie both supply obligation and tax relief.¹⁰⁹ According to a Commission study from 2009, the Member States using a combination of the two systems were also the Member States which saw the highest average annual growth rates of biofuels.¹¹⁰ However, as stated in the introduction, under the current environmental aid guidelines, which entered into force in 2014, joint application of these two measures are no longer, as a general rule, permitted.¹¹¹ The rationale underlying that prohibition is that as biofuels now are more established on the market, granting aid to a product that already has a guaranteed outlet via a supply obligation will not have an incentive effect on the beneficiary of the aid.¹¹² While it is beyond the scope of this thesis to discuss this restriction in detail, there is room to question the adequacy of this, as a general prohibition, from a (Swedish) climate perspective.¹¹³ Indeed, as stated in the introduction, the current instruments to promote biofuels are, according to the CPC, inadequate in light of the 2030 goal. Moreover, although there is legitimate concern for biodiversity loss in Swedish forests due to current forestry policies¹¹⁴, there is, according to most estimates, still room for substantial increases in domestic production of sustainable biofuels.¹¹⁵ On the other hand, this is only a problem if the tax reliefs entail State aid. Indeed, as Finland seemingly has gotten acceptance for its tax reliefs, which it introduced in 2011, as not entailing State aid, it is able to apply both instruments at the same time.

Determining whether the tax reliefs constitute State aid or not is therefore of crucial importance. However, before turning to the issue of selectivity of tax measures (in depth), the next chapter will provide the reader with a basic overview of the notion of State aid and its defining criteria.

¹⁰⁷ See Antón Antón (n 74), section 14.4, which show that this is exactly what happened in Spain.

¹⁰⁸ Prop 2017/18:1 (n 15), p 374f and 388.

¹⁰⁹ Antón Antón (n 74), section 14.3.

¹¹⁰ Commission, 'Renewable Energy Progress Report' SEC (2009) 503 final, p 20; Antón Antón (n 74), section 14.3.

¹¹¹ See EEAG (n 8), para 114.

¹¹² Cf Commission Decision N 57/2008 – Poland: Operating aid for biofuels, C (2009) 7140, paras 56-64. See *ibid*, paras 49 and 114.

¹¹³ For a discussion on the joint application of supply obligations and tax reliefs, see Antón Antón (n 74).

¹¹⁴ Malin Sahlin, *Från mångfald till enfald – en vitbok över den svenska modellen för skogsbruk* (Naturskyddsföreningen 2019); Camilla Andersson and Others, 'Fördjupad utvärdering av Levande Skogar 2019' (2019) Skogsstyrelsen 1.

¹¹⁵ See Maria Grahn and Julia Hansson, 'Prospects for domestic biofuels for transport in Sweden 2030 based on current production and future plans' (2015) 4 WIREs Energy and Environment 290; Pål Börjesson and others, 'Future demand for forest-based biomass for energy purposes in Sweden' (2017) 383 Forest Ecology and Management 17; Carlsson and Others (n 74); Per Kågeson 'Hur utforma en svensk kvotplikt för biodrivmedel?' (2015) Nature Associates 1, p 9ff.

3 The notion of State aid

3.1 Introduction

State aid control is unique to the EU. No other jurisdiction or trade area has similar provisions.¹¹⁶ The reason why the EU has equipped itself with such a unique regime has to do with the peculiarities of the European integration project. Indeed, in fulfilling the central element of this integration project, namely establishing an internal market, State aid control was from the very beginning considered necessary. It was feared that not doing so could lead to a “subsidy race”, where State support in one Member State triggered support in another Member State, thus undermining the creation and functioning of the internal market.¹¹⁷ In safeguarding the functioning of the internal market, EU State aid law therefore prohibits Member States’ action that distorts competition on that market.¹¹⁸ Thus, even though Article 107(2) and (3) TFEU are expressions of the fact that the Treaty recognises that in certain circumstances the benefit of granting aid to promote a legitimate objective may, on balance, outweigh the potential negative effects to competition and trade, the general rule is still that State aid is prohibited.¹¹⁹

Against that backdrop, the question of the interpretation of the notion of State aid in Article 107(1), or rather, how wide this notion is interpreted, becomes highly relevant. As will be seen in the following, and primarily in chapter 4, this is not the least so in relation to tax measures, on which the application of Article 107(1) has proved not only complex but also contentious.

3.2 Applicability of Article 107(1) TFEU to tax measures

Despite the above stated, it has since long been clear that Article 107(1) TFEU, as such, may apply to tax measures, even within the area of direct taxation where the EU has no competence – provided all the conditions of the provision have been satisfied.¹²⁰ This is also logical given that Article 107(1) TFEU, as will be seen below, applies to aid in “any form whatsoever”. Indeed, if that were not the case, Member States could too easily circumvent the State aid prohibition, to the detriment of the functioning of the internal market, by means of its tax prerogatives. However, a distinction should be made between situations where aid is granted in the form of a tax exemption or relief, and situations where the tax *itself* constitute aid. Generally, the latter situation falls outside the scope of Article 107(1) for two reasons. Firstly, a tax is a charge that generates revenue for the State. This means that the flow of resources is from the

¹¹⁶ The closest to the EU State aid regime are the anti-subsidy provisions in the World Trade Organisation (WTO). These are however more limited in scope and enforcement regime. See Bacon (n 30), p 4f.

¹¹⁷ Bacon (n 30), p 4f.

¹¹⁸ Diheng Xu, ‘Rationale Behind State Aid Control over Tax Incentives’ (2018) 2 World Competition 255, p 255. See, however, for a criticism of subsidies control, Alan O Sykes, ‘The Questionable Case of Subsidies Regulation: A Comparative Perspective’ (2010) 2 Journal of Legal Analysis 473.

¹¹⁹ See Werner and Verouden (n 39), p 16 and 26ff.

¹²⁰ See Case 173/73, *Italy v Commission* (“Italian Textile”), EU:C:1974:71, para 13, where the Court stressed, in response to Italy’s claim that the EU does not have competence in the field of direct taxation, that as the State aid rules are only concerned with the effects of a measure, the measures’ fiscal nature will not suffice to shield it from State aid control.

tax payer to the State, rather than the other way around. Secondly, Article 107(1) prohibit selective *advantages*, not selective *burdens*. This means that an undertaking generally cannot rely on Article 107 to claim relief from a higher rate of tax.¹²¹

There are however two exemptions to this general rule. The first concern situations where a tax forms an integral part of an aid measure. This principle was developed by the Court in *Van Calster*¹²² and subsequently refined in *Streekgewest*¹²³. The Court established in these cases that where a charge is hypothecated to the aid measure under the relevant national rules, in the sense that the tax revenue is tied to the financing of that aid and that the tax revenue has a direct impact on the amount of the aid, the tax *itself* falls within the scope of Article 107(1).¹²⁴ If that is the case, both the aid and the tax have to be notified to the Commission under Article 108(3) TFEU.¹²⁵

The second exemption arises in the unusual situation where the tax itself may be regarded as State aid for those undertakings which are not liable to pay the tax.¹²⁶ This was the case in *Laboratoires Boiron*¹²⁷, which concerned a French tax levied on the sales of pharmaceutical products by pharmaceutical laboratories, but not on the sales of medicines by wholesale distributors, with the specific intention of distorting competition in favour of the latter group. The Court concluded that the tax itself was the aid measure, whereby the taxed undertaking could claim reimbursement for the unlawful aid.¹²⁸ The unusual facts of this case highlight, however, that this situation is likely to be rare.¹²⁹ And as this thesis deals with tax reliefs, these two types of situations will not be dealt with further in this thesis.

3.3 The definition of State aid under Article 107(1) TFEU

Article 107(1) TFEU defines the concept of State aid under EU law and stipulates:

Save as otherwise provided in the Treaties, 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 shall, in so far as it affects trade between Member States, be incompatible with the internal market.

¹²¹ Maria Kleis and Phedon Nicolaides, 'Fiscal State aid and Environmental Protection: Analysis of a Conceptual and Practical Problem' (2010) *Tijdschrift voor Staatsreun* 1, p 5f; Bacon (n 30), p 58.

¹²² Joined cases C-261/01 and C-262/1 *Van Calster* EU:C:2003:571.

¹²³ C-174/02 *Streekgewest* EU:C:2005:10.

¹²⁴ *Ibid*, paras 24-26. See also C-206/06 *Essent Network* EU:C:2008:413, para 90.

¹²⁵ Bacon (n 30), p 59.

¹²⁶ Kleis and Nicolaides (n 121), p 4.

¹²⁷ C-526/04 *Laboratoires Boiron* EU:C:2006:528.

¹²⁸ *Ibid*, paras 30-40.

¹²⁹ Bacon (n 30), p 60.

As follows from the provision, Article 107(1) only applies if the recipient of the aid is an “undertaking”. The concept of undertaking is in this regard well established under competition law and encompasses every entity, regardless of its legal form, engaged in an economic activity; meaning that they are active on a competitive market where they offer goods or services.¹³⁰

The Court has consistently held that Article 107(1) does not distinguish between measures of State intervention by reference to their causes or aims, but defines them in relation to their effects.¹³¹ Indeed, as the provision applies to aid “in any form whatsoever” a State may not avoid characterisation of a measure as aid on the grounds that it is a fiscal measure, or pursues economic or social aims, or pursues public interest goals such as environmental protection.¹³² In cases concerning tax measures, the Court generally states that the following criteria need to be satisfied for a national measure to be classified as State aid within the meaning of Article 107(1): “First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between the Member States. Third, it must confer a selective advantage on the recipient. Fourth, it must distort or threaten to distort competition.”¹³³ In the following these criteria will be described.

3.3.1 Granted by the State or through State resources

For a measure to be categorised as State aid it has to be granted by the State or through State resources. These criteria appear to be alternative but are cumulative.¹³⁴ As was clarified in *PreussenElektra* it is necessary to show *both* that the measure involves State resources, whether directly or indirectly, *and* that it is imputable to the State.¹³⁵ To satisfy the criteria, the aid must entail “a burden on the public finances in the form either of expenditure or of reduced revenue”.¹³⁶ The concept of State resources is however not limited to resources stemming directly from the State treasury itself, but involves resources from public authorities as well as regional and local government.¹³⁷ Decisions by a public or private undertaking over which the State exercise a dominant influence is also imputable to the State.¹³⁸

Accordingly, in relation to tax measures in the form of exemptions or reliefs, this criteria will rarely constitute an issue as tax reliefs will burden public finances and is evidently imputable to the State.¹³⁹ However, in relation to the other main support system outlined above, ie supply obligations, this is generally the criterion which determines whether State aid is involved or not. This is so since, while it is relatively clear that an obligation on fuel suppliers to supply a

¹³⁰ Bacon (n 30), p 23.

¹³¹ See eg *Italian Textile* (n 120), para 13 and C-81/10 P *France Télécom* EU:C:2011:811, para 17.

¹³² Bacon (n 30), p 19f.

¹³³ See eg C-20/15 P *World Duty Free Group* EU:C:2016:981, para 53.

¹³⁴ Hofmann and Micheau (n 45), p 65.

¹³⁵ C-379/98 *PreussenElektra* EU:C:2001:160, paras 58-62.

¹³⁶ Case 82/77 *van Triggele* EU:C:1977:205, Opinion of AG Capotorti, p 52; Case 82/77 *van Triggele* EU:C:1978:10, para 25.

¹³⁷ See eg Joined cases T-228 and 233/99 *Westdeutsche Landesbank* EU:T:2003:57.

¹³⁸ Emily Forrester, ‘Is the State Aid Regime a Suitable Instrument to Be Used in the Fight Against Harmful Tax Competition?’ (2018) 1 EC Tax Review 19, p 21f.

¹³⁹ See Bacon (n 30), p 64; Joined cases C-78/08 to C-80/08 *Paint Graphos and Others* EU:C:2011:550, para 46.

fixed amount of biofuels will result in a selective advantage granted to biofuel producers that distorts competition and potentially affects trade between Member States, it is not certain that State resources are at stake.¹⁴⁰ In this regard the Court ruled in the *PreussenElektra* case that an obligation imposed on private electricity distribution undertakings to purchase a certain amount of electricity from renewable energy sources at State-fixed minimum prices, although conferring an advantage to the producers of renewable energy, did not involve a direct or indirect transfer of State resources to those undertakings.¹⁴¹

The Commission has thus stated that, equally, an obligation to supply a specific amount of biofuels will generally not involve a transfer of State resources.¹⁴² Neither will it involve State resources if the State issues certificates which are tradable between the fuel suppliers, if these are issued for free and only constitute proof that a certain amount of biofuels has been supplied to the market.¹⁴³ However, if, within the supply obligation system, some type of fine or penalty-mechanism is established that transit through a public or private entity designed to channel these funds to the beneficiaries, State resources will usually be involved.¹⁴⁴ For example, the UK Renewable Transport Fuel Obligation system was therefore considered to involve State resources as the penalty payable by the fuel suppliers that failed to supply the prescribed amount of biofuels was collected by a fund controlled by the State, which in turn redistributed the collected funds to the fuel suppliers on the basis of the number of certificates they surrendered.¹⁴⁵

Thus, while the Swedish emission reduction obligation scheme include a system to fine non-compliant fuel suppliers,¹⁴⁶ these funds will not be redistributed to the benefit of any particular beneficiary and therefore not involve a transfer of State resources. The same applies in this regard to the Finnish supply obligation system,¹⁴⁷ which is neither considered to involve State resources.

3.3.2 Selective advantage

Following the elements of Article 107(1), the criterion of selective advantage is actually two separate criteria. Indeed, to fall within the scope of Article 107(1) it is not enough that a State measure grants an economic advantage, that advantage must *also* selectively favour one or more undertakings over other undertakings.¹⁴⁸ However, in cases concerning taxation, this two-pronged test of “advantage” and “selectivity” is often merged by the Court into a question of

¹⁴⁰ Cf Commission Decision N 418/2006 – UK: Renewable Transport Fuel Obligation (RTFO), C (2007) 8 final, p 13; Antón Antón (n 74), section 14.5.2.

¹⁴¹ *PreussenElektra* (n 135), paras 3-10 and 59; Bacon (n 30), p 61.

¹⁴² See UK RTFO (n 140), p 13.

¹⁴³ *Ibid*, p 13; Antón Antón (n 74), section 14.5.2.

¹⁴⁴ Notice on the notion of State aid (n 43), para 63.

¹⁴⁵ UK RTFO (n 140), p 13 and 14. Similarly, for the Spanish supply obligation system, see Antón Antón (n 47), section 14.5.2. Cf, in this regard, *Essent Network* (n 124).

¹⁴⁶ See paragraph 10 of the Swedish Act (2017:1201) (n 16).

¹⁴⁷ See paragraph 11 and 12 of the 3rd chapter of the Finnish Act (446/2007) on promotion of the use of biofuels in transport.

¹⁴⁸ C-15/14 P *MOL* EU:C:2015:362, para 59.

whether a taxpayer enjoys a “selective advantage”,¹⁴⁹ where advantage is presumed if the selectivity test is satisfied.¹⁵⁰ As the selectivity criterion and the three-step test developed by the Court to determine the selectivity of a tax measure will be treated separately in chapter 4, this section will confine itself to briefly describe the main features of the notions of selectivity and advantage.

The objective of the selectivity criterion is to determine whether a measure unjustifiably favours certain undertakings while not granting the same advantage to undertakings that are in a comparable situation.¹⁵¹ As will be touched upon below, the concept of selectivity is thus closely linked to the concept of (non) discrimination.¹⁵² The selectivity criterion can furthermore be divided into regional and material selectivity.¹⁵³ Regional selectivity refers to measures which have a limited territorial application within a Member State¹⁵⁴ whereas material selectivity refers to measures that distinguish between undertakings (ie favours *certain* undertakings or the production of *certain* goods).¹⁵⁵ Material selectivity can be established either de jure or de facto. De jure selectivity refers to measures which are by their terms targeted at certain undertakings only, whereas de facto selectivity refers to measures which, on its face, appear to apply on the basis of objective and general terms, but which has the effects of favouring a particularly group of undertakings.¹⁵⁶ With regard to de jure selectivity, it could for example be where a tax relief is formally reserved to undertakings having a certain legal form,¹⁵⁷ whereas an example of de facto selectivity could be a tax measure that is reserved to investments exceeding a certain threshold, which may mean that that measure is de facto reserved for undertakings with significant financial resources.¹⁵⁸

An advantage, within the meaning of Article 107(1), is any economic benefit which an undertaking could not have obtained under normal market conditions¹⁵⁹, that is to say in the absence of State intervention.¹⁶⁰ As the concept of advantage is relative, identifying whether a

¹⁴⁹ See *World Duty Free Group* (n 133), paras 53 and 54; C-143/99 *Adria-Wien Pipeline* EU:C:2001:598, paras 41 and 42; Wolfgang Schön, ‘Tax Legislation and the Notion of Fiscal Aid: A Review of 5 Years of European Jurisprudence’ in Isabelle Richelle and Others (eds), *State Aid Law and Business Taxation* (Springer-Verlag 2016), p 7f.

¹⁵⁰ See *World Duty Free Group* (n 133), para 56; C-15/14 P *MOL* EU:C:2015:32, Opinion of AG Wahl, para 52.

¹⁵¹ Jérôme Monsenego, *Selectivity in State Aid Law and the Methods for the Allocation of the Corporate Tax Base* (Kluwer Law International 2018), p 3; C-203/16 P *Heitkamp* EU:C:2017:1017, Opinion of AG Wahl, para 99.

¹⁵² Monsenego (n 151), p 3.

¹⁵³ Phedon Nicolaides and Ioana Eleonora Rusu, ‘The Concept of Selectivity: An Ever Wider Scope’ (2012) 4 *EStAL* 791, p 792.

¹⁵⁴ Regional selectivity has arisen in the context of devolved or autonomous regions such as the Azores and Gibraltar. Thus, where a regional authority enjoys sufficient fiscal autonomy the selectivity of a tax measure should be assessed in comparison with the “normal” rate of taxation in that geographical area, as opposed to the Member State as a whole: see Bacon (n 30), p 81; C-88/03 *Portugal v Commission* (“Azores”) EU:2006:511.

¹⁵⁵ Nicolaides and Rusu (n 153), p 792.

¹⁵⁶ Notice on the notion of State aid (n 43), paras 121 and 122.

¹⁵⁷ See *Paint Graphos and Others* (n 139), para 52.

¹⁵⁸ Notice on the notion of State aid (n 43), paras 121 and 122. See, with regard to the latter example, joined cases T-92/00 and T-103/00 *Ramondin SA* EU:T:2002:61, para 39.

¹⁵⁹ To assess whether the State, in giving the advantage, has acted as a “normal market participant”, or not, the EU courts have developed a so-called “market economy operator test”. On this, see Bacon (n 30), p 38ff.

¹⁶⁰ Notice on the notion of State aid (n 43), para 66; C-39/94 *SFEI and Others* EU:C:1996:285, para 60.

measure has conferred an advantage on an undertaking requires a comparison with another situation. What is relevant in this respect is whether the financial situation of the undertaking following the measure has improved compared with its financial situation if the measure had not been taken.¹⁶¹ To this end the Court has stated that a measure may be an advantage even where its purpose is to compensate for a disadvantage.¹⁶²

As Article 107(1) covers aid in “any form whatsoever”, the advantage does not have to constitute a direct subsidy but could also come in the form of, for example, a tax relief or favourable loan guarantee or preferential interest rates, which the undertaking could not have obtained under normal market conditions.¹⁶³ However, as taxes stem from legislation, there is no “normal market condition” to compare with as only the State has the power to enact legislation. Thus, whether legislation produces a benefit to some undertakings will therefore simply run on the effects of the legislation itself, seen objectively.¹⁶⁴ If the effects of the legislation is to relieve the undertaking of an economic burden normally included in the budget of the undertaking, an advantage is granted.¹⁶⁵ As taxes constitute such a burden for undertakings, a tax relief will inevitably relieve the undertakings from that burden and therefore constitute an advantage.¹⁶⁶

3.3.3 Distortion of competition and effect on trade between Member States

The requirements that the measure should be liable to distort competition and affect trade between Member States are closely related and therefore often considered together, even though they remain, under Article 107(1), two distinct requisites.¹⁶⁷

The thresholds for establishing an effect on competition and inter-State trade are low.¹⁶⁸ It follows from Article 107(1) that it is sufficient that a measure *threatens* to distort competition. No actual effect on competition thus has to occur. Equally, no actual effect on inter-State trade has to be established – it is sufficient that the measure is *liable* to affect such trade.¹⁶⁹ The common trend within the EU courts’ case-law is therefore that no actual assessment of these criteria are required.¹⁷⁰ There is thus a *prima facie* presumption that as soon as a Member State grants a financial advantage to an undertaking in a liberalized market, there will be a distortion of competition and effect on inter-State trade.¹⁷¹ The Court has in this regard stated that when State aid “strengthen[s] the position of an undertaking compared with [an]other undertaking competing in intra-community trade, the latter must be regarded as affected by that aid”.¹⁷²

¹⁶¹ Notice on the notion of State aid (n 43), para 67.

¹⁶² See eg C-172/03 *Heiser* EU:C:2005:130, paras 52-54.

¹⁶³ *Craig and De Burca* (n 42), p 1133; *SFEI and Others* (n 160), para 60.

¹⁶⁴ *Bacon* (n 30), p 30; Joined cases C-533/12 P and C-536/12 P *SNCM* EU:2014:2142, para 34.

¹⁶⁵ *Heiser* (n 162), para 36.

¹⁶⁶ See *ibid*, para 38.

¹⁶⁷ *Bacon* (n 30), p 83. See eg Joined cases T-298/97, T-312/97 etc *Alzetta* EU:T:2000:151, para 81.

¹⁶⁸ *Bacon* (n 30), p 6.

¹⁶⁹ See eg C-518/13 *Eventech* EU:C:2015:9, para 65.

¹⁷⁰ See eg C-66/02 *Commission v Italy* (“banking tax advantage”) EU:C:2005:768, para 111.

¹⁷¹ *Hofmann and Micheau* (n 45), p 151f.

¹⁷² Case 730/79 *Philip Morris v Commission* EU:C:1980:209, para 41.

However, even where the aid recipient is not engaged in cross-border trade but operate on a local level, inter-State trade may be affected as it is sufficient that the aid may make it harder for operators in other Member States to enter that market.¹⁷³

The low thresholds are however partly tempered by the wide-ranging exemptions under Article 107(2) and (3) and the *de minimis*- and block exemption regulations adopted by the Commission.¹⁷⁴ In that regard, the GBER is of particular importance. Indeed, a specific objective of the Commission's 2012 State Aid Modernisation Plan¹⁷⁵ was to induce Member States to rely more on the GBER for its aid measures, so as to enable the Commission to more effectively focus its resources on unusual and larger measures which pose higher risk to competition and trade.¹⁷⁶ The scope of the GBER was therefore extensively widened in 2014 when the current GBER was adopted and several thresholds for allowable aid intensity was also raised. This has caused a surge in State aid granted without prior notification under the GBER. In 2017 as much as 96 % of all new aid reported since 2015 were block exempted, which represents an increase of about 28 percentage points compared to 2013.¹⁷⁷

3.4 Conclusions

Establishing and safeguarding the functioning of the internal market is one of the Union's primary objectives. The State aid rules serves in that respect to safeguard that objective by prohibiting, as a general rule, State intervention that distorts competition on the internal market. Yet, as shown above, no actual effects on competition and trade has to be established. As neither the criteria of State resources and imputability will be difficult to prove in relation to tax measures, the question in such cases boils down to whether a selective advantage has been given. In this regard, advantage is generally presumed if the selectivity test is satisfied. Indeed, as undertakings benefitting from a tax exemption or tax relief will be considered to have been granted an advantage, the question is if that advantage is available to other comparable undertakings as well. The selectivity criterion is thus the decisive element in determining whether a tax measure constitute State aid or not. However, as will be seen below, assessing selectivity may in some cases be far from an easy task.

¹⁷³ Hofmann and Micheau (n 45), p 154f. See eg C-280/00 *Altmark Trans* EU:C:2003:415, paras 77 and 78. However, for examples where aid was deemed not to affect inter-State trade, see Notice on the notion of State aid (n 43), paras 196 and 197.

¹⁷⁴ Bacon (n 30), p 6.

¹⁷⁵ Commission, 'EU State Aid Modernisation' (Communication) COM (2012) 209 final.

¹⁷⁶ Leigh Hancker and Phedon Nicolaides, 'Compatibility of Aid – General Introduction' in Philipp Werner & Vincent Verouden (eds), *EU State Aid Control: Law and Economics* (Kluwer Law International 2017), p 209.

¹⁷⁷ Commission, 'State aid scoreboard 2018: Results, trends and observations regarding EU28 State aid expenditure reports for 2017' (7 January 2019), p 25

<http://ec.europa.eu/competition/state_aid/scoreboard/state_aid_scoreboard_2018.pdf> accessed 26 May 2019.

4 The selectivity analysis

4.1 Introduction

This chapter will be exclusively dedicated to the selectivity criterion and the three-step test developed in the Court's case-law to assess the selectivity of complex cases involving in particular tax measures. In this regard it was stated above that State measures are assessed on the basis of their effects. The fact that a tax measure pursues policy objectives such as environmental protection may therefore not, as such, bring the measure outside the scope of Article 107(1). As a matter of fact, it has actually been questioned whether Member States, at all, can rely on external policy objectives, such as environmental protection, to justify differential treatment between undertakings. However, it will be argued in that regard that Member States in fact can in rely on such objectives. However, that is only if those objectives are integrated into, ie are not external to, the tax regime in question. It will moreover be argued that this is regrettable as it limits Member States possibilities to pursue legitimate policy objectives within a wider tax system and, furthermore, blurs the distinction between the second and the third step of the Court's three-step test.

4.2 The selectivity analysis as a three-step test

General measures that applies without distinction to all undertakings does not fall within the scope of Article 107(1) TFEU, whereas measures that selectively favours certain undertakings over other comparable undertakings do.¹⁷⁸ Particularly in tax matters this distinction between general and selective measures may however be far from straightforward.¹⁷⁹ Indeed, some tax measures may appear general, without providing for any explicit form of exemption, but nevertheless have selective effects.¹⁸⁰ By contrast, the selective nature of a measure is generally easier to determine where an activity or a product is exempted from a particular tax.¹⁸¹ For example, exempting biofuels from paying energy tax and CO₂ tax, which are levied on other motor fuels, seems clearly selective. However, also in cases where the differential treatment is evident, difficulties may arise with regard to the selectivity assessment. This is so since the case-law of the Court has established that a measure with differential effect may nevertheless escape classification as aid, where the favoured undertaking is not comparable to the non-favoured group of undertakings, or the different treatment is justified by the nature and logic of the relevant system.¹⁸² It is to address those issues that the three step-test has emerged in the Court's case-law.¹⁸³

¹⁷⁸ *World Duty Free Group* (n 133), para 56; *Adria-Wien Pipeline* (n 149), paras 35 and 36.

¹⁷⁹ *Nicolaides and Rusu* (n 153), p 792.

¹⁸⁰ See, in this regard, joined cases C-106/09 P and C-107/09 P *Commission and Spain v Government of Gibraltar and the United Kingdom* ("Gibraltar") EU:C:2011:732.

¹⁸¹ *Nicolaides and Rusu* (n 153), p 792.

¹⁸² *Bacon* (n 30), p 70. See eg *Adria-Wien Pipeline* (n 149), paras 41 and 42.

¹⁸³ Notice on the notion of State aid (n 43), paras 127 and 128; *Bacon* (n 30), p 70.

Under this test, the first step is to identify the “normal” tax system – a reference system. Secondly, it should be determined whether a given measure constitutes a derogation from that reference system, insofar as it differentiates between operators who, in light of the objective pursued by that system, are in a comparable factual and legal situation. If that is the case, the measure is *prima facie* selective. Under the third step, a *prima facie* selective measure may nevertheless be justified if the selectivity follows from the nature or the logic of that reference system.¹⁸⁴ In the following, this three-step analysis will be explained and discussed.

4.2.1 The reference system

As the aim of the selectivity analysis is to identify unequal treatment between undertakings in comparable situations, it is generally considered that identifying the relevant reference system is of particular importance to this analysis.¹⁸⁵ This is so since a comparison between undertakings only makes sense against a benchmark.¹⁸⁶ Identifying the appropriate reference system may, however, be far from easy.

The difficulty stems in part from the nature of taxation: tax systems are generally complex and may involve a number of variables determining the tax burden of undertakings, which thus makes it difficult to devise an exact criteria for *how* the relevant reference system ought to be determined.¹⁸⁷ In its Notice on the notion of State aid, the Commission, for its part, states that “the reference system is composed of a consistent set of rules that generally apply – on the basis of objective criteria – to all undertakings falling within its scope as defined by its objective”.¹⁸⁸ This means that in tax cases, the reference system is based on elements such as the tax base, the taxable persons, the taxable event and the tax rates.¹⁸⁹ The reference system could therefore be identified with regard to for example the corporate income tax system or the general system of taxation of insurance.¹⁹⁰ Generally, the Court favours a broad approach in determining the reference system.¹⁹¹

In *Paint Graphos*, for example, which concerned a rule exempting cooperative societies from corporate income tax, the Court motivated its determination of the reference system as constituting the corporate income tax system with the fact that the basis of assessment of corporation income tax was the same for cooperatives and other companies, namely, the amount

¹⁸⁴ Notice on the notion of State aid (n 43), para 128; *World Duty Free Group* (n 133), paras 57 and 58.

¹⁸⁵ *Azores* (n 154), para 56; Micheal Honoré, ‘Selectivity’ in Philipp Werner & Vincent Verouden (eds), *EU State Aid Control: Law and Economics* (Kluwer Law International 2017), p 146; Claire Micheau, ‘Tax selectivity in European law of state aid: legal assessment and alternative approaches (2015) 40 EL Rev 323, p 146; Max Lienemeyer and Flavia Tomat, ‘Application to specific fields – fiscal aid’ in Leo Flynn and Others (eds), *EU Competition Law: State aid*, vol IV (2 edn, Cleays & Casteels Pub 2016), p 425. For a different view on the importance of identifying the reference framework, see C-66/14 *Finanzamt Linz* EU:C:2015:242, Opinion of AG Kokott, para 88.

¹⁸⁶ *Heitkamp*, Opinion of AG Wahl (n 151), para 99; C-203/16 P *Heitkamp* EU:C:2018:505, para 88; Nicolaidis and Rusu (n 153), p 792.

¹⁸⁷ See *Heitkamp*, Opinion of AG Wahl (n 151), paras 100 and 101; Honoré (n 185), p 126.

¹⁸⁸ Notice on the notion of State aid (n 43), para 133.

¹⁸⁹ *Ibid*, para 133.

¹⁹⁰ *Ibid*, para 134.

¹⁹¹ See *Heitkamp*, Opinion of AG Wahl (n 151), paras 106-109; Bacon (n 30), p 71.

of net profit earned at the end of the tax year.¹⁹² However, in other cases it may not be enough to consider only the tax regime as a whole. The reference system may instead have to be identified by looking at a specific set of rules within a tax system. This has, for example, been the case in relation to some Member States' rules concerning the possibility for companies to carry forward losses incurred from their business activity to subsequent taxable periods.¹⁹³

While identifying the reference system may prove particularly difficult in the latter cases,¹⁹⁴ it is on the other hand, undoubtedly easier in cases of self-standing levies or taxes which do not form part of a wider system, such as environmental or health taxes. In such cases, the reference system is in principle the levy or tax itself.¹⁹⁵ Yet, the fact that the levy or tax itself forms the reference system, does not mean that the Commission and the EU courts will avail itself of evaluating whether the boundaries of the levy has been designed in a consistent manner having regard to the objective of the levy in question.¹⁹⁶ Indeed, as State aid is defined by its effects, paying too much deference to the formal scope of the tax would allow Member States to circumvent the State aid rules by their choice of legislative technique.¹⁹⁷ To exemplify this problem, consider a hypothetical tax levied on all air carriers, but which formally exempt public air carriers from the tax. Such a tax explicitly differentiate, within its scope, between two groups of undertakings; thus making the selectivity easy to detect. On the contrary, a tax levied on private air carriers, but not on public air carriers (referred to as non-taxation or asymmetrical taxation), excludes public air carriers from its scope all together but produces the exact same result.¹⁹⁸

Given that State aid is concerned with effects it would make no sense to distinguish between the two scenarios, as the only difference is the legislative technique used.¹⁹⁹ Thus, the reference system should necessarily include public air carriers also in the second scenario even if those undertakings are excluded from the scope of the tax. This point further underlines the fact, as concluded by the Court in the (in)famous *Gibraltar* case, that in certain circumstances it is not necessary or possible to identify a benchmark and a formal derogation from that benchmark.²⁰⁰ Instead, what matters is whether the tax imposes a difference in treatment between undertakings that are in a comparable situation with regard to the objective of the tax system.²⁰¹ In *Gibraltar* the objective of the tax reform under consideration was to introduce a general system of taxation

¹⁹² *Paint Graphos and Others* (n 139), para 50.

¹⁹³ See *Heitkamp* (n 186) concerning the German rules, and C-6/12 *P Oy* EU:C:2013:525 in relation to the Finnish rules. On this, see also Lienemeyer and Tomat (n 185), p 426-429.

¹⁹⁴ This is not the least illustrated by the divergent views of the GC and the CJEU on the identification of the reference system in *Heitkamp* (n 186). See also *Heitkamp*, Opinion of AG Wahl (n 151), paras 99-191.

¹⁹⁵ Lienemeyer and Tomat (n 185), p 429; Notice on the notion of State aid (n 43), para 134.

¹⁹⁶ Notice on the notion of State aid (n 43), paras 131.

¹⁹⁷ Hoffmann and Micheau (n 45), p 143; Honoré (n 185), p 146-149. Cf *Heitkamp* (n 186), para 92.

¹⁹⁸ See C-53/00 *Ferring* EU:C:2001:253, Opinion of AG Tizzano, para 38 who is the author of this example, which has been subsequently used by Honoré (see Honoré (n 185), p 147). See also Axel Cordenwener, 'Asymmetrical Tax Burdens and EU State Aid Control' (2012) 6 EC Tax Review 288, p 289ff. For an example of such asymmetrical taxation, see C-233/16 *ANGED* EU:C:2018:280, paras 46-48.

¹⁹⁹ Honoré (n 185), p 147. See, to this effect, *ANGED* (n 198), para 46.

²⁰⁰ *Gibraltar* (n 180), paras 91-93. See also, to that effect, *World Duty Free Group* (n 133), para 77.

²⁰¹ *Monsenego* (n 151), p 24. See also C-233/16 *ANGED* EU:C:2017:852, Opinion of AG Kokott, para 88.

for companies established in Gibraltar.²⁰² As that was the objective, the Court concluded that the tax measures – a payroll tax based on the number of employees, a business property occupation tax depending on the size of business premises, an annual registration fee, and a requirement to make profit – although drafted in general manners with no formal derogations, in effect/de facto would provide a selective advantage to offshore companies, as such companies generally do not have any employees and occupy no business property.²⁰³

The *Gibraltar* case in this regard highlights the importance attributed to the objective of the measure at stake for establishing, as Prek and Lefèvre put it, the “the circle of undertakings” whose tax treatment should be compared in step 2.²⁰⁴ Thus, as the objective of the proposed tax reform was to introduce a general system of taxation for all companies established in Gibraltar, that circle was constituted by all undertakings established on Gibraltar.²⁰⁵

It is evident from the above that the Court may broaden the group of undertakings or activities considered, if the objective set by the national legislator cannot be reasonably limited to the particular activity or situation of only some of them.²⁰⁶ However, this should primarily be a concern in non-harmonised areas where the Member States, in principle, enjoy complete freedom in terms of deciding the scope and policy objectives of its tax measures.²⁰⁷ With regard to the Swedish and Finnish energy and CO₂ taxes, those are considered harmonised excise duties under the ETD. The main question in this situation instead seems to be which objective, the objective of the national taxes or that of the ETD, that should guide the selectivity analysis.

4.2.2 Derogation from the reference system – comparability assessment

Once the reference system has been identified, the next step is to establish whether a tax measure, in derogating from that reference system, differentiates between undertakings which are in a legal and factual situation that is comparable *in light of the objective pursued by the system of reference*.²⁰⁸ It is thus not only necessary that a measure derogates (or has similar effects, as in the case of non-taxation explained above) from the reference system, the measure must also create unequal treatment between comparable subjects. In this regard, the objective of the tax system becomes, as stated above, of paramount importance.

²⁰² *Gibraltar* (n 180), para 8 and 11.

²⁰³ *Gibraltar* (n 180), paras 100-107.

²⁰⁴ Miro Prek and Silvére Lefèvre, 'The requirement of Selectivity in the Recent Case-Law of the Court of Justice' (2012) 2 *EstAL* 335, p 339.

²⁰⁵ *Ibid*, p 339. It has in this respect been argued that if Gibraltar would only have been able to demonstrate that the objectives of the measures was not the establishment of a general system of corporate taxation, but rather the imposition of a payroll tax and a business property occupation tax, it would have been safe from State aid scrutiny as no Member State is obliged to have a general tax on profits at all (see Raymond Luja, 'The Selectivity Test: The Concept of Sectoral Aid' in Alexander Rust & Clair Micheau (eds), *State Aid and Tax Law* (Kluwer Law International 2013), p 112).

²⁰⁶ Hoffmann and Micheau (n 45), p 135.

²⁰⁷ See Notice on the notion of State aid (n 43), para 156.

²⁰⁸ See *Adria-Wien Pipeline* (n 149), para 41; *World Duty Free Group* (n 133), paras 54 and 57.

In this respect the Commission states in its Notice that the comparability of undertakings may only be assessed “in the light of the *intrinsic* objectives of the system of reference.”²⁰⁹ Thus, external policy objectives, such as environmental protection “cannot be relied upon by the Member States to justify the differentiated treatment of undertakings.”²¹⁰ Only in relation to special-purpose levies, such as environmental taxes, which “normally integrate the policy objectives pursued”, may such (external) policy objectives according to the Commission justify a difference in treatment.²¹¹ However, Honoré argues, on the contrary, that this is not a correct reading of the case-law of the CJEU, which, according to him, allows external policy objectives to be considered under step 2 – and not just for special-purpose levies.²¹² That is to say, Honoré seems to argue that Court’s case-law provides for a possibility to rely on environmental objectives to justify differential treatment between undertakings also when the derogating measure providing for the difference in treatment forms part of a tax regime which does not pursue environmental objectives. As this has particular bearing on the selectivity assessment of the Swedish and Finnish energy and CO₂ taxes, as they are harmonised by the ETD, which objective is not primarily environmental, this will be discussed in the following.

4.2.2.1 *The relevance of external policy objectives such as environmental protection for the comparability assessment in relation to special purpose levies – British Aggregates and ANGED*

The Commission and Honoré seem to agree on the fact that the Court’s case-law allow for differentiation between undertakings on the basis of policy objectives, such as environmental protection, in relation to special-purpose taxes. However, there seem, previously, to have been some uncertainty as to whether environmental objectives could be relied on, *at all*, for the purpose of Article 107(1). This uncertainty has its roots in statements made by the CJEU in *Spain v Commission* and *British Aggregates*.

In *British Aggregates* the General Court (GC)²¹³ concluded that the environmental levy under assessment, which aimed at taxing certain aggregates (a form of rocks used in construction), was *not* selective as it pursued environmental policy objectives. The GC held in this regard that, in the absence of EU harmonisation, Member States were free to set their “priorities as regards the protection of the environment and, as a result, to determine which goods or services they are to [tax].”²¹⁴ In rejecting this approach, the CJEU, upon appeal, stated that the GC’s position, which meant that an environmental objective as such could lead to the conclusion that the measure was not selective, was at variance with the effects-based approach underlying Article 107(1).²¹⁵ The CJEU then continued to state – in response to the GC’s finding that it is for the Commission, when assessing a specific measure, to take account of the environmental protection requirements referred to in Article 11 TFEU – that

²⁰⁹ Notice on the notion of State aid (n 43), para 135 (emphasis added).

²¹⁰ *Ibid*, para 135.

²¹¹ *Ibid*, para 136.

²¹² Honoré (n 185), p 162.

²¹³ Previously the Court of First Instance. For the purpose of clarity, I will only use General Court.

²¹⁴ T-210/02 *British Aggregates I* EU:T:2006:253, paras 114 and 115.

²¹⁵ C-487/06 P *British Aggregates II* EU:C:2008:757, paras 84-87.

the need to take account of requirements relating to environmental protection, however legitimate, cannot justify the exclusion of selective measures, even specific ones such as environmental levies, from the scope of Article [107(1) TFEU] (...) *as account may in any event usefully be taken of the environmental objectives when the compatibility of State aid measures with the common market is being assessed pursuant to Article [107(3) TFEU].*²¹⁶

The CJEU referred in this regard to the earlier *Spain v Commission* case where the CJEU held that “[t]hose [environmental] grounds, however legitimate, and supposing them to be established, are ineffective at the stage of the assessment of a national measure with regard to Article [107(1)] of the Treaty”.²¹⁷ On the basis of these statements it has therefore been argued that environmental objectives would not play any role in the application of the selectivity criterion and Article 107(1) in general.²¹⁸

However, although the CJEU can be criticised for using an overly strong wording²¹⁹, this contention does not seem to be a correct reading of the cases. As Nowag notes the CJEU in *Spain v Commission* and *British Aggregates* (as well as in its subsequent *Dutch NOx* ruling where the same dicta occurred²²⁰) actually accepted that environmental protection could be an objective pursued by States.²²¹ The CJEU only rejected the GC’s position that an environmental objective *as such* could remove the measure from the scope of Article 107(1) TFEU.²²² Indeed, after having sent the case back to the GC in *British Aggregates*, the GC, upon re-examination, concluded that the levy *was* selective *in light of the environmental objective* of the levy. This was so as the scope of the levy had been defined in a clearly arbitrary manner, in so far as it did not tax certain aggregates which were equally harmful to the environment as those taxed.²²³ The issue was thus, as discussed in relation to the reference system above, that the scope of the aggregates levy (the reference system) was narrower than its stated objective.²²⁴

The relevance of environmental protection objectives was further confirmed by the CJEU in the recent case *ANGED*²²⁵. The case concerned a regional environmental tax levied by the

²¹⁶ *British Aggregates II* (n 214), para 92 (emphasis added).

²¹⁷ C-409/00 *Spain v Commission* EU:C:2003:92, para 54.

²¹⁸ See Nicolas de Sadeleer, ‘State Aids and Environmental Protection: Time for Promoting the Polluter-Pays Principle’ (2012) 1 Nordic Environmental Law Journal 3, p 16; Conor Quigley, ‘Direct Taxation and State Aid: Recent Developments Concerning the Notion of Selectivity’ (2012) 40 Intertax 112, p 118f. See also C-487/06 P *British Aggregates II* EU:C:2008:419, Opinion of AG Mengozzi, paras 97 and 102. Cf Julian Nowag, *Environmental integration in competition and free-movement laws* (OUP 2017), p 102.

²¹⁹ See Andreas Bartosch, ‘Is there a need for a rule of reason in European State aid law? Or how to arrive at a coherent concept of material selectivity?’ (2010) 47 CLM Rev 729, p 740.

²²⁰ C-279/08 P *Commission v Netherlands* (“Dutch NOx”) EU:C:2011:551, para 75.

²²¹ Nowag (n 217), p 108. See also Bartosch (n 218), p 745f.

²²² Nowag (n 217), p 108; *British Aggregates II* (n 214), paras 84-87.

²²³ T-210/02 RENV *British Aggregates III* EU:T:2012:110, paras 55 and 71-93. See Kleis and Nicholaides (n 121), p 7.

²²⁴ See Nicolaidis and Rusu (n 153), p 796.

²²⁵ *ANGED* (n 198).

Autonomous Region of Catalonia²²⁶ on individual large retail establishments (over 2500 m²) aimed at offsetting the impact of those large establishment on the environment. The tax thus excluded from its scope collective retail establishments and retail establishment with a sales area below 2500 m², but did also formally exempt certain specialised establishments, such as garden centres and businesses selling vehicles, even if they had a sales area over 2500 m². The Court noted in this regard that it was not disputed that larger retail establishments, due to its higher attendance of visitors, will have larger adverse effect on the environment. Thus, setting a condition relating to the sales area was, according to the Court, consistent with the tax regime's environmental objective. Small and large retail establishments were therefore not factually comparable in light of the environmental objective of the tax, whereby the non-taxation of smaller retailers did not entail State aid in favour of those retailers.²²⁷

Neither did, according to the Court, the tax exemption for the specialised establishments entail a selective advantage in favour of those undertakings. In this regard the argument was that these retailers pursued businesses that generally require, by their very nature, a larger sales and storage area but which will not attract the greatest number of costumers and therefore entail lower environmental impact. The Court found that argument sensible and stated that “provided that those establishments do not have a significant an adverse effect on the environment (...) [t]hat factor may be such as to *justify* the distinction adopted in the contested legislation”.²²⁸ On the contrary, the Court found no justification to exclude collective large (over 2500 m²) retail establishments from the scope of the tax. The non-taxation of those undertakings was therefore considered to constitute State aid.²²⁹ Noteworthy is that the Court seems to have held that the specialised establishments, contrary to the situation in relation to small retailers, *were* comparable with other large retailers and that the tax exemptions therefore had to be justified under step 3.²³⁰ However, the Court is not entirely clear in this regard.²³¹ As will be discussed below, it is indeed difficult at times to distinguish steps 2 and 3 from each other.

In sum, it seems that the Court was more deferential in *ANGED* than in *British Aggregates* of Member States' margin of discretion in designing their environmental taxes.²³² Yet, more importantly, it is clear from the above cases, and in particular *ANGED*, that Article 107(1) allow Member States to differentiate between undertakings on the basis of environmental objectives. However, such differentiation presuppose that it is applied in a consistent manner with regard to the environmental logic underlying the tax in question. Both *British Aggregates* and *ANGED* however concerned special-purpose taxes. The question therefore is whether the Court's case-

²²⁶ It was not disputed between the parties that the tax was not regionally selective (see *ANGED* (n x), para 45). Similar taxes was also imposed by the Principality of Asturias (see C-234/16 *ANGED* EU:C:2018:281) and the Autonomous Community of Aragon (see C-236/16 *ANGED* EU:C:2018:291).

²²⁷ *ANGED* (n 198), paras 53-56.

²²⁸ *Ibid*, paras 57-60 and 67 (emphasis added).

²²⁹ *Ibid*, paras 61 and 68.

²³⁰ Cf Monsenego (2019) (n 25), p 93f.

²³¹ Cf Nicolas de Sadeleer, 'Preliminary ruling on the compatibility of taxation of superstores with the right to freedom of establishment and State aid law: Case C-233/16, *ANGED*' (2018) *Reciel* 341, p 346, who seems to consider that the Court actually held that specialised establishments were not comparable with large retailers.

²³² Cf Monsenego (2019) (n 25), p 92-94; de Sadeleer (2018) (n 231), p 346.

law, as argued by Honoré, also allow for such external policy objectives to be relied on outside the realm of special-purpose levies?

4.2.2.2 *Can Member States rely on external policy objectives such as environmental protection outside the realm of special-purpose levies?*

As a starting point it should be emphasised that the Commission, in its Notice, does not seem to distinguish between general tax regimes and special-purpose levies as to whether intrinsic or extrinsic objectives may be relied on. This is so as the policy objective pursued (eg protection of the environment or public health) is generally integrated into the underlying logic of special-purpose levies; in effect making the objective intrinsic/internal (and not external) to the tax. The Commission thus seems to consider that objectives external to a tax, whether it is a general tax regime or a special-purpose levy, never can be relied on.²³³

This position, that is to say, only allowing the “intrinsic objectives of the (*reference*) system” to be relied on under step 2, denies, according to Honoré, “Member States the possibility to demonstrate that there is no discrimination between economic operators, having regard to the objective of the measure, which may indeed be of an *extrinsic* character.”²³⁴ Such a position would furthermore, argues Honoré, constitute a radical departure from a long-standing line of cases, such as *Adria-Wien Pipeline*, *Maribel bis/ter*, *Dutch Greenhouses*, *Dutch NOx* and *Kernkraftwerke Lippe*, “where extrinsic objectives were (...) examined by the [CJEU]” under step 2.²³⁵

Before reviewing whether that is the case, is it worth clarifying the distinction, pointed to by Honoré, between looking at the (broader) objective of the *tax/reference system*, and looking at the (narrower) objective of the *measure in question*. This distinction originates in the different formulations used by the EU courts over the years,²³⁶ which in turn has given rise to discussions in the academic literature on whether it is the former or the latter that should be used as the yardstick for the comparison.²³⁷ The choice may indeed be important, as the objectives of the two do not need to match. On the one hand, in cases where a particular tax regime and a measure that forms part of it have objectives that are consistent and complementary (as is often the case with special-purpose taxes) it does not really make a difference which objective that is relied on, as they will pursue the same goal.²³⁸ On the other hand, where a specific measure has an objective (eg employment policy) that does not really link with the objective of the broader system of which it forms part (which is often simply to collect revenue), the question whether

²³³ See Notice on the notion of State aid (n 43), paras 135 and 136.

²³⁴ Honoré (n 185), p 163 (emphasis added).

²³⁵ Ibid, p 163.

²³⁶ Lienemeyer and Tomat (n 185), p 430.

²³⁷ See Rita Szudoczky, ‘Convergence of the Analysis of National Tax Measures under the EU State Aid Rules and the Fundamental Freedoms’ (2016) 15 EStAL 357, p 366-368; Bartosch (n 218), p 741ff; Jose Luis Buendia Sierra, ‘Finding Selectivity or the Art of Comparison’ (2018) EStAL 85, p 89. See also Humbert Drabbe, ‘The test of selectivity in State aid litigation: the relevance of drawing internal and external comparisons to identify the reference framework’ in Alexander Rust & Clair Micheau (eds), *State Aid and Tax Law* (Kluwer Law International 2013), p 96ff.

²³⁸ Monsenego (n 151), p 76.

it is the *measure's* objective or the *system's* objective which guides the comparison becomes highly relevant.²³⁹ The main problem, in such cases, with taking the objective *of the measure* as a yardstick for the comparison is that it may often lead to circular reasoning.²⁴⁰ That is to say, if the objective of the measure *is* to favour a specific category, leaving other categories outside make sense and would not be selective.²⁴¹ In other words, the comparative exercise may prove rather meaningless if the circle of undertakings to be compared are only those favoured by a specific measure.²⁴² Deciding *which* objective that should be used as a yardstick for the comparison may therefore be very important for the outcome of the selectivity analysis.

While the EU courts as stated has used both formulations, it seems that, in the past, the Court's choice of whether to take the objective of the *measure* or that of the *system* into account largely depended on the tax measure under assessment:²⁴³ in relation to stand-alone levies, the Court referred to the measure's objective,²⁴⁴ whereas it referred to the system's objective where the measure formed part of a broader tax system²⁴⁵. By now, it nevertheless seems clear that it is the broader approach (ie the objective of the *system/tax regime* – irrespective of the tax measure under review) that the Court favours.²⁴⁶ This conclusion would then mean, as held by the Commission, that it is only where a certain policy objective is integrated into a tax regime (ie it is not external to it) that it may justify a difference in treatment.

Having said that, the question is then whether this conclusion, as claimed by Honoré, does in fact constitute a departure from earlier case-law. In other word, did the Court previously allow objectives external to a tax system to be taken into account under step 2? Honoré refers in this regard, first, to the *Adria-Wien Pipeline* case. This case concerned a rebate from an energy tax granted only to undertakings manufacturing goods, while not granting the same rebate to undertakings supplying services. In this case the Court indeed referred, for the comparability assessment, to the objective of “*the measure in question*”.²⁴⁷ In this regard, the Court found that the tax rebate was selective as “[e]nergy consumption by each of those sectors is equally damaging to the environment.”²⁴⁸ Here, two observations should be made. Firstly, although referring to the objective of the *measure in question*, the Court actually seems to have used the objective of the *tax system* (ie the energy tax) as the relevant yardstick.²⁴⁹ This is so as the objective of the measure in question (the tax rebate to undertakings manufacturing goods) was

²³⁹ Monsenego (n 151), p 76; Szudoczky (n 236), p 367. Cf T-251/11 *Austria v Commission* EU:T:2014:1060, para 106.

²⁴⁰ Szudoczky (n 236), p 367; Sierra (n 236), p 89.

²⁴¹ Sierra (n 236), p 89.

²⁴² See *Paint Graphos and Others* (n 139), paras 50-62; Szudoczky (n 236), p 367. See also Prek and Lefèvre (n 203), p 340f. Cf *World Duty Free Group* (n 133), para 94, where the Court stated that the question is “whether the situation of operators benefitting from [a] measure is comparable with that of operators excluded from it”.

²⁴³ Lienemeyer and Tomat (n 185), p 430.

²⁴⁴ See *Adria-Wien* (n 149), para 41; RENV *British Aggregates* (n 222), para 47.

²⁴⁵ See C-308/01 *GIL Insurance* EU:C:2004:252, para 68; *Heiser* (n 162), para 40.

²⁴⁶ Monsenego (n 151), p 77 and 79. See *Gibraltar* (n 180), para 101; *Paint Graphos and Others* (n 139), para 49; C-5/14 *Kernkraftwerke Lippe-Ems* EU:C:2015:354, para 74; *P Oy* (n 193), para 19; *World Duty Free Group* (n 133), para 54; *Heitkamp* (n 186), para 83; *ANGED* (n 198), para 38.

²⁴⁷ *Adria-Wien Pipeline* (n 149), para 41 (emphasis added).

²⁴⁸ *Ibid*, para 52.

²⁴⁹ Cf *Drabbe* (n 236), p 96.

not environmental, but rather aimed at preserving the competitiveness of the manufacturing sector.²⁵⁰ On the contrary, the objective of the *energy tax* was to tax energy consumption. And it was, in fact, in light of *this* objective that the Court concluded that the two sectors were in a comparable situation.²⁵¹ It would therefore have been more correct if the Court had referred (as is standard today) to the objective of the *tax regime/system*. Secondly, as the tax in question did pursue environmental objectives, Honoré's conclusion that the Court in this case allowed external policy objectives to be taken into account, does not seem entirely convincing. On the contrary, the case rather seems to be in line with the position outlined in the Commission's Notice, in so far as taking environmental objectives into account under an environmental tax is not external to that tax, but rather internal to it.

The same conclusion seems, equally, to be applicable in relation to the other cases referred to by Honoré. Firstly, in *Maribel bis/ter* the measure under consideration was a Belgian social security scheme which provided for a reduction in social security contributions in respect of manual workers for undertakings in certain industry sectors whose activity was most exposed to international competition. The Court did in this case indeed not question Belgium's right to rely on employment policy objectives.²⁵² However, neither in this case was the policy objective relied on external to that measure but rather formed an integral part of the social security scheme under consideration. Secondly, in both *Dutch Greenhouses*²⁵³ and in *Dutch NOx*²⁵⁴ did the measures under consideration (a mineral levies system aimed at reducing emissions of fertilisers into the environment, in the former, and a NOx trading scheme aimed at reduce emissions of NOx in the latter) have environmental protection objectives. Also in these cases is it therefore possible to argue that the policy objectives relied on by the Netherlands, and accepted as such by the Court, were not external to those measures. Similarly, and lastly, was neither the objective of taxing nuclear fuel in accordance with the polluter-pays principle, relied on by Germany in *Kernkraftwerke Lippe-Ems*, external to the German nuclear fuel tax under consideration, but rather internal to that tax.²⁵⁵ Thus, in all these cases do the policy objectives relied on by the Member States in fact seemed to have formed an integral part of, or were at least not unrelated to²⁵⁶, the reference system under consideration.

From the above the following conclusions can be drawn. First, what matters for the comparability analysis is the objective of the reference system/tax regime. Member States may therefore not rely on objectives which are unrelated (extrinsic) to that tax regime.²⁵⁷ Second, this approach seems, moreover, not to constitute "a radical departure" from previous case-law. In none of the above cases, which date back to 1999 (*Marible bis/ter*) is it, in my opinion,

²⁵⁰ *Adria-Wien* (n 149), para 54.

²⁵¹ See Clair Micheau, *State Aid, Subsidy and Tax Incentives under EU and WTO Law* (Kluwer Law International 2014), p 277f.

²⁵² *C-75/97 Belgium v Commission* ("Maribel bis/ter") EU:C:1999:311, paras 37-39.

²⁵³ *C-159/01 Netherlands v Commission* ("Dutch Greenhouses") EU:C:2003:339.

²⁵⁴ *Dutch NOx* (n 219).

²⁵⁵ *Kernkraftwerke Lippe-Ems* (n 245), para 78. However, for a different assessment, see Cordenwener (n 198), p 290f.

²⁵⁶ Cf *Paint Graphos and Others* (n 139), para 70; *P Oy* (n 193), para 27.

²⁵⁷ Cf Micheau (2015) (n 185), p 341f. Cf also *ANGED*, Opinion of AG Kokott (n 201), para 100.

possible to say that the policy objectives relied on were external to the regimes under consideration.

4.2.3 Justification

If a tax measure is considered *prima facie* selective it may nevertheless escape classification as State aid under step 3, if “justified by the nature or general scheme of that system.”²⁵⁸ A *prima facie* selective measure is justified by the nature or general scheme when the differentiation derives directly from the inner logic,²⁵⁹ or “guiding principles” of a tax system.²⁶⁰ or when it is the result of inherent mechanisms “necessary for the functioning of the effectiveness of the system.”²⁶¹ The Court has in this regard made clear that tax measures which are the result of external policy objectives unrelated to the tax system of which it forms part cannot be relied on as a justification under step 3.²⁶² It moreover follows from settled case-law that this concept is to be interpreted strictly,²⁶³ and that the derogation must comply with the principle of proportionality and not go beyond what is necessary to achieve the objective being pursued.²⁶⁴

Given that it is argued above that, in effect, also for step 2, only policy objectives inherent to a tax system may be relied on, one may wonder what added value the third step actually has? Indeed, Bondi for example argues that the third step should “simply [be] absorbed in the analysis of whether the measure has discriminated between undertakings” as the “justified by the logic of the system test is an integral part of the equality test that the Court has to carry out [under step 2]”.²⁶⁵ The difficulty of separating step 2 from step 3 has moreover been observed by Prek and Lefèvre.²⁶⁶ It has however been observed that merging steps 2 and 3 is problematic in so far as the burden of proof under step 2 rests with the Commission, whereas under step 3 the burden of proof rests with the Member States.²⁶⁷ Thus, from that point of view it seems wise to continue to treat step 2 and step 3 separately.²⁶⁸

That being said, as only objectives internal to a system may be relied on for both step 2 and step 3, their functions remain similar. However, there seems nevertheless to be a difference in what type of intrinsic policy objectives the Court has admitted under step 2 and step 3. So far, the Court has primarily admitted intrinsic fiscal objectives under step 3.²⁶⁹ The Commission therefore lists, in its Notice, as basis for a possible justification, *inter alia*, the need to fight fraud

²⁵⁸ See eg *Adria-Wien* (n 149), para 42.

²⁵⁹ See C-222/04 *Ministero dell’Economia e delle Finanze* EU:C:2006:8, para 137.

²⁶⁰ See *P Oy* (n 193), para 22; *Paint Graphos and Others* (n 139), para 65 and case-law cited.

²⁶¹ See *Azores* (n 154), para 83.

²⁶² *Paint Graphos and Others* (n 139), paras 69 and 70; *P Oy* (n 193), paras 24-30.

²⁶³ Joined cases T-127/99 etc *Diputación Foral de Álava* EU:T:2002:59, para 250; *Bacon* (n 30), p 79.

²⁶⁴ *Paint Graphos and Others* (n 139), para 75; Notice on the notion of State aid (n 43), para 140.

²⁶⁵ Andrea Biondi, ‘State aid is falling down, falling down: An analysis of the case law on the notion of aid (2013) 50 CLM Rev 1719, p 1737.

²⁶⁶ Prek and Lefèvre (n 203), p 342f.

²⁶⁷ *Dutch NOx* (n 219), para 62.

²⁶⁸ Cf *Sierra* (n 236), p 90f.

²⁶⁹ See *GIL Insurance* (n 244), paras 73-78; *Paint Graphos and Others* (n 139), para 71; Joined cases C-128/03 and C-129/03 *AEM SpA and AEM Torino* EU:C:2005:224, paras 41-43; *Honoré* (n 185), p 160f.

or tax evasion, the progressive nature of income tax and its redistributive purpose, the principle of tax neutrality, or the need to avoid double taxation.²⁷⁰ That is, all fiscal in nature.

Nevertheless, there seems to be nothing in the Court's case-law that explicitly says that non-fiscal policy objectives, such as environmental protection, cannot be relied on under step 3; provided that objective is inherent to the tax system, that is to say, in relation to for example environmental taxes.²⁷¹ First, in the *Dutch Greenhouse* case mentioned above, which concerned an exemption from a levy, aimed at regulating the use of fertilisers in view of protecting the environment, in favour of certain types of agriculture, the Court indeed seems to have accepted, *as such*, that the differentiation created could have been justified by the nature and general scheme of the tax in question. The issue was only that the Dutch government was not able to adduce sufficient scientific proof demonstrating the extent to which the type of agriculture benefitting from the exemption had a lesser negative impact on the environment than other types.²⁷²

Second, in the *Dutch NO_x* case, the Court, although refusing to take into account the claimed objective, seems to have left "the door open" for such a possibility.²⁷³ Under the trading scheme in question, larger industry facilities (thermal capacity of more than 20 MWth) could monetize the economic value of their emission reductions, either by selling their emission allowances or by buying allowances from other undertakings and therefore avoiding a fine.²⁷⁴ The GC had concluded in this regard that "the beneficiary undertakings are determined in accordance with the nature and general scheme of the system" and that "[e]cological considerations justify distinguishing undertakings which emit large quantities of NO_x from other undertaking".²⁷⁵ In rejecting this finding, the CJEU stated that "the substantial NO_x emissions of the undertakings covered by the measure in question and the specific reduction standard applicable to those undertakings *are not sufficient* to enable the measure to avoid classification as a selective measure".²⁷⁶ As noted by Prek and Lefèvre, the use of the word "not sufficient" rather than "not relevant" implies that such considerations *might* be taken into account.²⁷⁷ Moreover, the Court also noted that "such a differentiation between undertakings based on a quantitative criterion, that is to say total installed thermal capacity of more than 20 MWth, cannot be regarded as inherent to a scheme intended to reduce industrial pollution and, therefore, justified only on environmental grounds".²⁷⁸ Equally, such a statement is, as Prek and Lefèvre argues, tantamount to admitting, albeit implicitly, that within such a scheme, differences of treatment might be justified in view of its objective. The issue was only that the Court did not find it inherent in a scheme aimed at reducing emissions to accord favourable treatment to precisely

²⁷⁰ Notice on the notion of State aid (n 43), para 139.

²⁷¹ Prek and Lefèvre (n 203), p 343f. See also, in this regard, Szudoczky (n 236), p 373ff.

²⁷² *Dutch Greenhouses* (n 252), paras 44-47; Prek and Lefèvre (n 203), p 344.

²⁷³ Prek and Lefèvre (n 203), p 344.

²⁷⁴ Micheau (2014) (n 250), p 279f.

²⁷⁵ T-233/04 *Netherlands v Commission* EU:T:2008:102, para 99.

²⁷⁶ *Dutch NO_x* (n 219), para 76 (emphasis added).

²⁷⁷ Prek and Lefèvre (n 203), p 344.

²⁷⁸ *Dutch NO_x* (n 219), para 76.

those undertakings emitting the most.²⁷⁹ Lastly, as stated above, it seems that the Court in *ANGED* actually relied on step 3 (justification) when it held that the tax exemptions granted to specialised establishments was not selective, as those establishments had a lesser impact on the environment than other large retail establishments.²⁸⁰

Having said that, it remains a fact that the Court (generally) interprets the justification test restrictively and that Member States have to adduce sufficient proof that any differentiation is applied consistently with the tax system's inner logic or inherent objective(s).²⁸¹ As the search for the "inner logic" of a tax system necessarily involve some elements of subjectivity²⁸² it may however be difficult to foresee from one case to another whether the Union courts will accept the justification put forward or not.²⁸³ Needless to say this is regrettable from the point of view of legal certainty. As has moreover been pointed to by many scholars, this approach naturally limits Member States' possibilities to use its wider tax systems, such as its corporation tax, to pursue various policy objectives.²⁸⁴ In response to this, it has therefore been proposed that Member States *should* be able to rely on "permissible" objectives, such as environmental protection, also when they are external to a tax regime. That is to say, taking a "rule of reason" approach, equal to the *Cassis*-doctrine²⁸⁵ developed by the Court under the fundamental freedoms, whereby the Member States are able to justify restrictions to trade on the basis of overriding reasons relating to public interest.²⁸⁶

Such an approach seems sensible. Indeed, one may wonder why a stand-alone tax, pursuing permissible policy objectives, should be less harmful to competition than measures based on the same permissible policy objectives adopted within a wider tax system? As long as such measures pursue a legitimate objective, are applied consistently and comply with the principle of proportionality in the sense that it is suitable and necessary for achieving the objective purposed, it is difficult to see why that should not be permitted.²⁸⁷ Arguably, such an approach is tantamount to saying that Member States legislative technique *does* matter for the purpose of determining whether a State measure pursuing, for example, environmental objectives constitute State aid or not. Moreover, such an approach would also help distinguishing the second and third steps of the selectivity analysis in so far as the justification test would then, contrary to

²⁷⁹ Prek and Lefèvre (n 203), p 344.

²⁸⁰ *ANGED* (n 198), paras 60 and 67.

²⁸¹ See, to this effect, *Austria v Commission* (n 238), para 117.

²⁸² Cf Richard Lyal, 'Transfer Pricing Rules and State Aid' (2015) 38 *Fordham International Law Journal* 1017, whom at p 1036 summarised the justification test through asking a question: "does this rule make sense in terms of this tax or of the tax system as a whole?"

²⁸³ Monsenego (n 151), p 182.

²⁸⁴ See Honoré (n 185), p 163; Szudoczky (n 236), p 373ff; Bartosch (n 218), p 748ff; Nicholaides and Rusu (n 153), p 802f.

²⁸⁵ Case 120/78 *Rewe-Zentral AG* EU:C:1979:42. See, in this regard, Craig and De Búrca (n 42), p 704ff.

²⁸⁶ Szudoczky (n 236), p 373ff; Frank Engelen and Anna Gunn, 'State Aid: Towards a Theoretical Assessment Framework' in Alexander Rust & Clair Micheau (eds), *State Aid and Tax Law* (Kluwer Law International 2013), p 150; Cf Bartosch (n 218), p 746-752. See also Leigh Hancher, 'Towards a new definition of a State aid under European Law: Is there a new concept of State aid emerging?' (2003) *EStAL* 366, p 366-368.

²⁸⁷ Cf Szudoczky (n 236), p 374; Engelen and Gunn (n 286), p 150.

what is done under the comparability assessment, take the objective of *the measure* into account, rather than the objective of *tax system*.²⁸⁸

As has been shown, this is however not permissible under the current state of the law. As will be seen below, the fact that only objectives inherent to a system can be relied on is crucial for the assessment of the selectivity of the Swedish and Finnish energy and CO₂ taxes.

4.3 Conclusions – only a tax system’s internal objectives are relevant for the selectivity analysis

The selectivity criterion serves to determine whether any unjustified differential treatment between comparable undertakings is caused by a State measure. The concept of selectivity is thus very similar to the concept of discrimination. In this regard, the three-step test serves as a tool to identify whether any such discrimination is at hand. As the selectivity of a State measure is however determined on the basis of its effects, the three-step test cannot be applied too rigidly as it may at times be necessary to look beyond the formal scope of a tax. Accordingly, it is not necessary that a given measure (always) formally derogates from a main rule or system in order to conclude that a selective advantage is given. In this analysis, identifying the objective(s) underlying a tax regime is decisive to the outcome of the selectivity analysis. Indeed, what the Court primarily seems to search for is coherence in a tax system, evaluating whether a given measure is applied consistently having regard to the underlying logic/objective of the system of reference. This is nonetheless a task marked by uncertainty and it can be very difficult to foresee from one case to another, particularly where there is no rule that formally derogates from a given system, whether a measure is selective or not.

As has been shown, it is moreover possible to rely on environmental objectives to justify differential treatment of undertakings. However, that seems only possible if the environmental objective is integrated into the tax regime under consideration. If a tax measure on the other hand is based on policy objectives unrelated (external) to the broader tax system of which a given measure forms part, a selective advantage will most likely be found to exist. As has been argued by some, this approach is regrettable. Indeed, this has the consequence, first, to delimit Member States’ possibilities to pursue permissible/legitimate policy objectives within a wider tax system – arguably leading to Member States’ legislative technique gaining in importance in contradiction with the effects-based approach underlying Article 107(1) TFEU – and second, to blur the distinction between steps 2 and 3 of the three-step test.

With that in mind, I will now, in the following two chapters, turn to address the specific situations of the Swedish and Finnish energy taxation systems and how the potential selective elements of the energy and CO₂ taxes forming part of those systems are affected by the fact that they are harmonised taxes under the ETD.

²⁸⁸ Cf Szudoczky (n 236), p 379.

5 Tax reliefs to promote biofuels – the ETD and the Swedish and Finnish energy taxation systems

5.1 Introduction

In this chapter the thesis will explain the Swedish and Finnish energy taxation systems. As the potential selective nature of these tax systems, as stated, is affected by the presence of the ETD and its underlying logic, it is necessary to start by describing the main features of the ETD and in particular its Article 16 which regulate the possibility to apply tax reliefs to biofuels.

5.2 The Energy Taxation Directive (ETD)

5.2.1 The main rule under the ETD and the Commission's proposed revision

The ETD was adopted in 2003 as an internal market directive with the main aim of ensuring, not the protection of the environment, but the proper functioning of the internal market for energy products and electricity.²⁸⁹ This was however not the initial intent. Indeed, as taxation on energy and CO₂ emissions for several decades have been viewed as a suitable tool to protect the environment and curb emissions of CO₂, the Commission proposed, twice, in the beginning of the 90s a framework for a common CO₂/energy tax.²⁹⁰ These proposals however failed to receive the unanimous support of the Council needed to adopt fiscal measures for environmental protection.²⁹¹ Consequently, the Commission from 1997 onwards instead focused on protecting the internal market, since it was seen under threat due to too divergent energy product pricing among Member States.²⁹² As also fiscal internal market directives requires unanimity in the Council,²⁹³ it took however another 6 years of negotiation until the ETD was finalised in 2003.

The ETD sets minimum rates for the taxation of energy products used as motor fuels, heating and electricity.²⁹⁴ For liquid motor fuels (ie diesel and petrol) these minimum rates are based on volume.²⁹⁵ No minimum rates are set for biofuels in the ETD. However, it follows from Article 2(3) that motor fuels, for which a minimum rate is not specified in the directive, shall be taxed at the rate of its equivalent fossil fuel for which a minimum rate is set. This has been interpreted to mean that for example biodiesel should be taxed at the same rate as diesel, and ethanol at the same rate as petrol. In other words, the main rule under the ETD is to tax motor fuels, fossil or renewable, equally on the basis of volume at a level that at least complies with the minimum rates set for diesel and petrol. However, by choosing volume, rather than energy

²⁸⁹ See recital 2 and 3 of the ETD (n 28); Antón Antón and Villar Ezcurra (n 29), p 56f.

²⁹⁰ See Commission, 'Proposal for a Council Directive Introducing a Tax on Carbon Dioxide Emissions and Energy' COM (1992) 226 final; Commission, 'Amended proposal for a Council Directive introducing a tax on carbon dioxide emissions and energy' COM (1995) 172 final.

²⁹¹ See, what is now, Article 192(2) TFEU; Antón Antón and Villar Ezcurra (n 29), p 56.

²⁹² Commission, 'Proposal for a Council Directive restructuring the Community framework for the taxation of energy products' COM (1997) 30 final; Antón Antón and Villar Ezcurra (n 29), p 56; Krämer (n 62), p 350.

²⁹³ See, what is now Article 113 TFEU.

²⁹⁴ Article 2, 4 and 7 of the ETD (n 28); Antón Antón and Villar Ezcurra (n 29), p 57.

²⁹⁵ Article 7(1) of the ETD (n 28). For natural gas, which biogas is considered equivalent to, the rate is set in kg.

content and CO₂ emissions as the basis for calculating the tax rates, the ETD creates incentives that are in contradiction with the energy and climate objective of the EU.²⁹⁶ According to the Commission the current minimum rates based on volume of the energy products consumed leads to inefficient energy use and distortions in the internal market. It furthermore discriminates against renewables as they are taxed at the same rate of the conventional fuel which they replace even though their energy content is lower.²⁹⁷ Thus, “the ETD provides no incentive or even price signal to promote alternative energies and encourage consumers to save energy.”²⁹⁸ To rectify these deficiencies the Commission therefore proposed in 2011 to revise the ETD.²⁹⁹ More specifically, the Commission proposed to split the minimum rate of taxation of energy products into two parts: one based on CO₂ emissions of the energy product (minimum carbon tax), but where the CO₂ related part of the taxation would be zero for all biofuels that comply with the sustainability criteria laid down in Article 17 of the RED; and the other based on energy content of the energy products, thus incentivising energy savings.³⁰⁰

Unfortunately, the proposal was withdrawn in 2015 when Member States’ failed to reach agreement in the Council.³⁰¹ One of the main stumbling blocks was that Member States with large shares of coal in its energy mix has been unwilling to let go of the favourable treatment given to coal under the ETD.³⁰² In an attempt to break the deadlock, the Commission on 9 April 2019 released a new Communication, where it proposes to trigger the “passerelle clause” in Article 192(2) TFEU, which would entail a shift from unanimity to qualified majority voting in the Council in relation to fiscal measures for environmental protection.³⁰³ However, given that such a decision in itself requires unanimity, the odds in favour of such a move does not seem too good. The Swedish Parliamentary tax committee, as well as the Swedish government, was for example quick to firmly reject any idea of moving away from unanimity in the field of taxation.³⁰⁴ Thus, until Member States are either ready to let go of its vetoing power in relation to taxation or able to unanimously agree on a revised ETD we will remain stuck with the ETD in its current form.

²⁹⁶ Antón Antón and Villar Ezcurra (n 29), p 57f; Federica Pitrone, ‘Design of Energy Taxes in the European Union: Looking for a Higher Level of Environmental Protection’ in Marta Villar Ezcurra and Others (eds), *Energy Taxation, Environmental Protection and State Aids* (IBFD 2016), section 7.1.1.

²⁹⁷ Commission, ‘Smarter energy taxation for the EU: proposal for a revision of the Energy Taxation Directive’ (Communication) COM (2011) 168/3, p 5f.

²⁹⁸ *Ibid*, p 6.

²⁹⁹ Commission, ‘Proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity’ COM (2011) 169 final.

³⁰⁰ COM (2011) 168/3 (n 297), p 7; Pitrone (n 296), section 7.2.4.

³⁰¹ Commission, ‘Withdrawal by the Commission’ OJ C80/19, 7 March 2015.

³⁰² See Marc Ringel and Michèle Knodt, ‘The governance of the European Energy Union: Efficiency, effectiveness and acceptance of the Winter Package 2016 (2017) 112 Energy Policy 209, p 208f.

³⁰³ Commission, ‘A more efficient and democratic decision making in EU energy and climate policy’ (Communication) COM (2019) 177 final.

³⁰⁴ Skatteutskottets utlåtande 2018/19:SkU24, Granskning av meddelande om ett förändrat beslutsfattande för EUs skattepolitik, p 11-13.

5.2.2 Derogation from the main rule – biofuel tax reliefs under Article 16

While the main rule accordingly is to tax motor fuels on the basis of volume, the ETD provides for several exemptions to this rule. For biofuels, Article 16(1), as stated, provides Member States with the possibility to apply tax reliefs for such fuels. The relief may however, according to Article 16(2), only be applied to the part of the fuel that actually derives from biomass. That is to say, the fossil part of blended fuels may not be subject to an exemption or reduced rate of taxation. Following Article 16(2) second subparagraph, the tax reliefs “may [also] be lower than the minimum levels [provided for by the ETD]”. A contrario this should mean that Member States has to apply Article 16 even if tax levels on biofuels complies with the minimum levels in the ETD, but are lower than those levied on its fossil counterpart.³⁰⁵ This interpretation also finds support when reading Article 16(2) in light of Article 5. Article 5 namely provides an exhaustive list of cases in which “differentiated rates of taxation may be applied [above the minimum levels]”. That is to say, if not authorised by another provision of the ETD, such as Article 16, Member States may *only* apply differentiated rates in the cases listed in Article 5, which indeed does not mention differentiation on the basis environmental performance such as CO₂ emissions or energy content.³⁰⁶

As to the possibility that tax reliefs under Article 16 may constitute State aid, it is specifically stated in Article 26(2) that any tax reliefs or exemptions authorised in the Directive may constitute State aid. The connection to the State aid rules is furthermore reflected in Article 16(3), which incorporate, as stated above, the prohibition on overcompensation contained in the EEAG. As was described above, the prohibition on overcompensation stems from the State aid principles that aid shall be limited to what is necessary and proportionate.³⁰⁷ It thus seems that any tax relief granted to biofuels under Article 16(1) is presumed to constitute State aid, in that such a relief will constitute a derogation not justified by the internal logic of the ETD.³⁰⁸ Having said that, the question is then why the Commission seems to have accepted that the Finnish energy taxation system does not involve State aid, despite differentiating between fossil fuels and biofuels? Before turning to address that issue in more detail, I shall first describe the Swedish and Finnish energy taxation systems.

³⁰⁵ Cf Commission Decision 2009/972/EC of 18 June 2009 on aid scheme C 41/06 which Denmark is planning to implement for refunding the CO₂ tax on quota-regulated fuel consumption in industry [2010] OJ L345/18, para 14, where the Commission appears to make the same conclusion.

³⁰⁶ Article 5 does mention “product quality”, which eg Sweden has been able to rely on for the purpose of applying different rates of taxation on petrol and diesel on the basis of environmental classification (miljöklass 1 och 2) (see eg paragraph 1, subparagraph 1 a and b of the 2nd chapter of the Swedish Act (1994:1776) on taxation of energy (LSE)). However, the Commission has not accepted that “product quality” can be relied on to differentiate between fossil fuels and biofuels on the basis of CO₂ emissions and energy content (Interview with Susanne Åkerfeldt, Senior Legal Adviser, Swedish Ministry of Finance (Stockholm, Sweden, 28 March 2019)).

³⁰⁷ See EEAG (n 8), paras 69 and 70.

³⁰⁸ See Antón Antón and Villar Ezcurra (n 29), p 60ff; COM (2011) 169 final (n 299), p 3.

5.3 The Swedish energy taxation system

The Swedish energy taxation system consist, as has already been mentioned, of two separate tax components: an energy tax and a CO₂ tax.³⁰⁹ While the energy tax has historically been primarily a fiscal tax, its character as an instrument to contribute towards the national and EU targets for increased energy efficiency has increased during the last decade. This means that the goal is to apply the energy tax in proportion to the energy content of the fuel.³¹⁰ However, while steps in this direction has been taken during the last years, diesel is still taxed at a lower level than petrol in proportion to its energy content.³¹¹ High-blended and pure biofuels are currently fully exempt from paying energy tax.³¹²

The CO₂ tax, for its part, was introduced in 1991 and has since then been the Swedish government's primary instrument in the fight against climate change.³¹³ The tax is levied on fossil carbon emissions, thus exempting emissions caused by combustion of biofuels. This is achieved by way of a tax deduction in the tax payer's energy and CO₂ tax declaration.³¹⁴ However, only biofuels fulfilling the sustainability criteria in Article 17 of the RED are eligible for tax exemptions.³¹⁵ As was shown above, this method is consistent with the Commission's proposed revision of the ETD. While the main objective of the CO₂ tax is thus to reduce GHG emissions resulting from burning fuels containing fossil carbon, an interlinked objective is also to increase the share of sustainable renewable energy, including biofuels.³¹⁶

As stated in the introduction, the Commission has continuously held that the Swedish tax exemptions are selective, albeit compatible under the environmental aid guidelines. This position seems in fact to be well established Commission practice also in relation to other Member States.³¹⁷ The current exemptions, with regard to high-blended and pure biofuels, was approved in September 2017 and will, as stated, remain in force until end of 2020.³¹⁸ With regard to low-blended biofuels now subject to the emission reduction obligation, those biofuels are no longer eligible for tax exemptions in line with the prohibition in the EEAG.³¹⁹

However, before the introduction of the emission reduction obligation, the Swedish government had for several years searched for a satisfactory solution to the promotion of biofuels. While the situation has partly been solved with the introduction of the reduction obligation, a solution is yet to be found for high-blended and pure biofuels, which risks in fact to be knocked out of

³⁰⁹ See paragraph 1 of the 2nd of the LSE (n 306); prop 2009/10:41 (n 101), p 110.

³¹⁰ Prop 2009/10:41 (n 101), p 120f.

³¹¹ Ibid, p 113, 120f and 171; prop 2017/18:1 (n 15), p 383.

³¹² Paragraph 3c 1 of the 7th chapter of the LSE (n 306).

³¹³ Non-aid notification in SA.36972 Annex I (n 26), p 1f.

³¹⁴ Paragraph 3a and b of the 7th chapter of the LSE (n 306).

³¹⁵ Paragraph 3c 1 subparagraph of the 7th chapter of the LSE (n 306).

³¹⁶ Non-aid notification in SA.36972 Annex 1 (n 26), p 2 and 7; prop 2009/10:41 (n 101), p 118.

³¹⁷ See eg Commission Decision NN 61/2004 – Spain: Excise duty exemptions to biofuels C (2006) 2293 final; Commission Decision N 63/2008 – Italy: Excise Duty reduction for biofuels, C (2008) 4589 final; N 57/2008 (n 112).

³¹⁸ See SA.48069 (n 19).

³¹⁹ Cf paragraph 3a of the 7th chapter of the LSE (n 306).

the market in the absence of support.³²⁰ In this regard, the government has during the years tried to find a solution where the energy taxation system does not involve any State aid, as that would enable, apart from creating predictability for high-blended and pure biofuels, tax reliefs also for low-blended biofuels subject to a quota obligation. Finding such a solution would moreover solve the situation with the upcoming ban on granting aid to food-based biofuels after 2020. As will be discussed below when discussing how the ETD impacts the selectivity assessment of tax reliefs granted under Article 16 of the ETD, the government first tried to argue that the current CO₂ tax scheme, which grant full exemption for sustainable biofuels, is justified by the nature and logic of the CO₂ tax.³²¹ In connection with that, it was also proposed that biofuels would no longer be eligible for exemption from the energy tax, which would be levied at the same rate, based on the energy content of the fuel, so as to avoid any elements of State aid in the energy taxation system.³²² As the government failed to get acceptance for this view, it started to investigate ways to re-design the energy taxation system. Internal (now official) documents reveal in this regard that the government was advised by the Commission during informal discussions to look closer at the Finnish energy taxation system.³²³ As will be explained below, the Finnish system is based on a CO₂ tax based on life cycle analysis and an energy tax based on the energy content of the fuel.

It can however be questioned whether the Finnish energy taxation system pass the selectivity test. Some support for this preliminary conclusion can be drawn not only from section 5.2.2 above, but also from the fact that internal documents and sources at the Swedish Ministry of Finance reveal that the Commission (although not in any formal decision) continued to have issues with the Swedish energy taxation system even after civil servants at the Government Offices discussed the possibility to re-design the energy taxation system along the lines of the Finnish model.³²⁴

5.4 The Finnish energy taxation system

The Finnish energy taxation system consist, as in Sweden, of an energy tax (called energy content tax) and a CO₂ tax.³²⁵ With regard to the CO₂ tax, Finland introduced it, as the first country in the world, just shortly before Sweden did.³²⁶ However, as was explained in section 2.3.1 above, Finland's main tool to promote biofuels has not been, and is not, tax reliefs. Instead, Finland decided, as stated above, back in 2007 to introduce a supply obligation as a

³²⁰ See prop 2017/18:1 (n 15), p 385.

³²¹ See non-aid notification in SA.36972 Annex I (n 26).

³²² Non-aid notification in SA.36972 Annex II (n 26), p 2.

³²³ Ministry of Finance, Sweden, 'Unofficial memo: SA 36972 – National design of a CO₂ tax' (23 April 2015), p 3.

³²⁴ Ministry of Finance, Sweden, 'The Future of CO₂ taxation in the EU' (2 July 2015), p 4f; interview with Susanne Åkerfeldt (n 306).

³²⁵ See paragraph 1 of the Finnish Act (1472/1994) on excise duty on liquid biofuels (LPB).

³²⁶ Mikael Skou Andersen, 'Reflections on the Scandinavian Model: Some Insights into Energy-Related Taxes in Denmark and Sweden' in Marta Villar Ezcurra and others (eds) *Energy Taxation, Environmental Protection and State Aid* (IBFD 2016), section 4.1.

means to comply with its obligation under the RED.³²⁷ In fact, before 2010 Finland was one of few Member States not to apply any tax reliefs for biofuels.³²⁸ In the course of a larger energy tax reform in 2011 (which was refined in 2012) Finland, however, changed the basis for calculating the excise duty levied on motor fuels to one where the energy tax is based on the energy content of the fuel and where the CO₂ tax is based on life cycle analysis for both biofuels and fossil fuels.³²⁹ The CO₂ tax for biofuels is to this end based on the default values for the expected life cycle emission savings of different biofuels, compared to their equivalent fossil fuels, contained in Annex V of the RED. As explained in section 2.3 above, biofuels are only considered sustainable if they achieve GHG emission savings of at least 50 %. Following that logic the CO₂ tax is halved for first generation biofuels, while second-generation (advanced) biofuels, which are double-counted under the RED, are given full exemption from the CO₂ tax.³³⁰

In relation to fossil fuels, the Finnish Parliament decided to add to the CO₂ emitted during combustion (tank-to-wheel), an average calculated amount of CO₂ emitted during production of the fuel and transportation (well-to-tank). This was done in 2012 in order to apply life cycle thinking consistently for both fossil fuels and biofuels and was, according to the preparatory works, a requirement from the Commission in order to avoid a State aid investigation with regard to the CO₂ tax scheme.³³¹ According to the Finnish government, the aim of the energy taxation system is thus *not* to promote biofuels, but only to tax all motor fuels as objectively and neutrally as possible on the basis of their energy content and CO₂ emissions.³³² It is however worth noting that Finland has no formal Commission decision as to the non-aid character of its energy taxation system. This fact is arguably reflected by the slightly cautious language used in the preparatory works. It is stated that Finland “believe” its energy taxation system not to involve State aid as the differentiation entailed in the energy tax and CO₂ tax, according to the Finnish government, is justified by the nature and logic of that system.³³³

5.5 Conclusions

From the above it can be seen that the ETD, as an internal market directive, was proposed as a “solution” after the Commission had failed to get acceptance for a more environmentally oriented EU wide CO₂/energy tax. For at least a decade it has, however, been evident that the current model – whereby taxation is based on volume, rather than environmental performance – is outdated and not in line with the EU’s current climate and energy objectives. Due to the

³²⁷ RP 231/2006 (n 104) p 8.

³²⁸ Cansino and Others (n 6), p 6018.

³²⁹ Paragraph 1 of the LPB (n 325); RP 147/2010 rd Regeringens proposition till Riksdagen med förslag till ändring av lagstiftningen om energibeskattning, p 23-26; RP 26/2012 rd, Regeringens proposition till riksdagen med förslag till lag om ändring av 1 § lagon om punktsaktt på flytande bränslen, p 3f.

³³⁰ RP 26/2012 (n 329), p 2 and 5. The reliefs presuppose, needless to say, not only GHG emission savings, but that the biofuel complies with all sustainability criteria in Article 17 of the RED (see paragraph 2, subparagraph 27a and b of the LPB (n 325)).

³³¹ RP 26/2012 (n 329), p 4.

³³² Ibid, p 2.

³³³ Ibid, p 2; RP 191/2018 (n 27), p 15.

unanimity requirement in the fiscal domain the ETD has regrettably not yet been revised and will most likely remain in force for yet some time, as some Member States' are unwilling to abandon their vetoing power in the field of taxation.

Under the current ETD Member States are therefore dependent on Article 16 for the possibility to grant tax reliefs to biofuels. Such exemptions are, however, generally considered by the Commission to constitute State aid in favour of biofuel producers. Interestingly, the Finnish energy taxation system has seemingly been accepted by the Commission, although not in any formal decision, as not entailing State aid, despite exempting sustainable biofuels, either partially or fully, from CO₂ taxation. Admittedly, taxing on the basis of energy content and CO₂ emissions in a life cycle perspective seems coherent with the logic underlying that system. Moreover, as biofuels in Finland, contrary to biofuels in Sweden, are not exempted from energy taxation, they comply with the minimum levels in the ETD. However, the Finnish energy tax and CO₂ tax, as the Swedish equivalents, are harmonised excise duties for the purpose of the ETD. As noted above, it follows from a combined reading of Article 5 and Article 16(2) second subparagraph, that Article 16(1) has to be applied as soon as biofuels are subject to lower levels of taxation than its fossil counterparts, even if respecting the minimum rates. And as there seems to be a presumption, when Article 16 is applied, in favour of a finding of State aid, it seems doubtful that the Finnish energy taxation system does not involve selective elements.

Indeed, as will be shown below, it seems to me only possible to come to a conclusion of non-aid if it is the logic of the Finnish energy tax and CO₂ tax that guides the selectivity assessment. If that would be the case, then the same should arguably apply in relation to the Swedish energy taxation system. But then one could also question why the Swedish CO₂ tax scheme is considered selective. Accordingly, what the question boils down to in the end is whether it is the logic of the national taxes or the ETD that should guide the analysis. These are questions that will be discussed in the last chapter.

6 The influence of the internal logic of the ETD when declaring Article 16 reliefs as selective aid

6.1 Introduction

In this chapter the selectivity criterion will be applied to tax reliefs granted under Article 16 of the ETD as exemplified with the Swedish and Finnish cases. As it is clear that the current Swedish tax exemptions (primarily due to the energy tax exemption) constitute State aid, the discussion as far as the Swedish energy taxation system is concerned, will primarily serve to illustrate the impact that the ETD has on the conclusion that that is the case. In that regard, I will take as a point of departure the argumentation used by the Swedish government back in 2013 when it argued for its CO₂ tax scheme as not entailing State aid.

In regards to the Finnish energy taxation system I will argue that it in fact appears to contain State aid in favour of biofuel producers, despite the fact that the Commission, seemingly, has accepted that that is not the case. Finally, it is important to analyse the differences between the Swedish and the Finnish systems and discuss why the Commission seems to have accepted the Finnish model. This is not the least so since the ETD, due to the unanimity rule, may not necessarily be revised as soon as would be desirable. As the ETD may remain in force for yet some time, it is moreover interesting to discuss possible ways forward in relation to the promotion of biofuels in Sweden. As will be remembered, it is indeed rather urgent to find a long-term solution for high-blended and pure biofuels as those fuels, in the absence of any support, risks being knocked out off the market.

6.2 The reference system

As was described above, the first step in analysing selectivity of a tax measure is to identify the reference system against which the measure should be assessed. With regard to stand-alone levies, such as environmental taxes, which does not form part of a wider system of taxation, it was stated that the tax or duty itself constitute the system of reference. As to the Swedish and Finnish energy and CO₂ taxes, they form, on the one hand, together part of the respective State's energy taxation system, but are, on the other hand, two separate excise duties, with partly separate objectives. For the latter reason it may seem reasonable to assess the taxes separately for the purpose of the selectivity analysis. This is also the view taken by both the Swedish and the Finnish governments. The Swedish government, for its part, argued back in 2013 that the CO₂ tax was the "normal" regime and that the evaluation of its selective nature should only relate to the logic of the tax itself and that it is applied consistently.³³⁴

However, the question is whether that is correct given the fact that these taxes are considered harmonised excise duties under the ETD. Admittedly, the Commission states in its Notice on the notion of State aid, in a footnote, that the stand-alone levy will remain the system of

³³⁴ Non-aid notification in SA.36972 Annex I (n 26), p 3 and 14.

reference even if a levy is introduced in the national legal system to transpose a Union directive.³³⁵ However, what if two levies are relied on for the purpose of complying with the Union directive? Indeed, in Commission Decision 2009/972/EC, concerning a Danish aid scheme under which energy-intensive businesses covered by the EU ETS would be exempt from paying CO₂ tax, the Commission concluded that the system of reference was the existing general energy tax system, which meant all taxes levied on the consumption of each energy product subject to taxation under the ETD. In Denmark, just like in Sweden and Finland, that is an energy tax and a CO₂ tax, which thus formed, together, the reference system. This was according to the Commission in line with Article 4(2) of the ETD, according to which all indirect taxes on the same energy product can be added together for the purpose of meeting the Union minimum levels of taxation under the ETD.³³⁶

One could argue that the same reasoning should be applied in the present cases.³³⁷ Indeed, the Swedish and Finnish energy and CO₂ taxes falls within the scope of Article 4 of the ETD. Article 4 stipulate to this end, in its first paragraph, that the level of taxation applied on energy products may not be lower than the minimum rates in the ETD, where the “level of taxation”, according to paragraph 2, is the total charge levied in respect of all indirect taxes (except VAT) on the energy product in question. From that point of view it seems reasonable to hold that the reference system against which the biofuel tax reliefs should be assessed is all taxes introduced by Sweden and Finland, respectively, to comply with the ETD (ie the energy tax and CO₂ tax in the respective countries).

However, there are two reasons why I will nonetheless analyse and discuss the selectivity of the respective countries’ energy tax and CO₂ tax separately. Firstly, as it, as stated, is clear that the Swedish tax exemptions constitute State aid, the discussion in relation to the Swedish taxes serves primarily to illustrate how the ETD impact that conclusion. That is to say, would the current exemptions constitute State aid in the absence of harmonisation, or if the ETD would be amended according to the Commission’s proposal? And as the energy tax and CO₂ tax has, partly, different objectives, it makes more sense, in that respect, to analyse them separately. Secondly, in relation to the Finnish taxes, it is clear from its preparatory works that the Finnish government has discussed the selectivity of its energy tax and CO₂ tax (also with the Commission) separately.³³⁸ And as the primary aim with regard to the Finnish taxes are to analyse and discuss whether they are in fact selective or not, it makes more sense to analyse that from the point of view of the argumentation put forward by Finland as to why they are *not* selective.

Moreover, as already mentioned above, the three-step test should not be applied too rigidly. Instead, its main purpose is to serve as a tool to determine whether any unjustified

³³⁵ Notice on the notion of State aid (n 43), para 134 (note 208).

³³⁶ *Denmark* (n 305), recital 40.

³³⁷ See Antón Antón (n 74), section 14.5.1.1, which indeed states that, for the purpose of tax reliefs under Article 16 of the ETD, the reference system should be “identified with regard to all energy taxes introduced by EU Member States to comply with the ETD.”

³³⁸ See RP 191/2018 (n 27), p 7.

discrimination is at hand. And as that assessment depends, in these cases, on the objective of the system of which the measure forms part, deciding which objective (the objective of the national taxes or that of the ETD) that should guide the analysis, is the decisive question in these cases.³³⁹

6.3 Comparability assessment and justification

As has been explained above, it must be considered settled case-law that – both for the comparability assessment (step 2) and the justification test (step 3) – only objectives internal to a tax system can be relied on.³⁴⁰ As was moreover explained above, this makes the second and third step to perform very similar functions. Admittedly, it was also stated that they should remain separate as the burden of proof lays on different actors for the respective steps. However, in a context, such as this one, that is not adversarial in nature, it makes a discussion easier if these steps are not treated in separate sections. Indeed, this is generally what the Court does in the non-adversarial context of preliminary rulings.³⁴¹

That being said, for steps 2 and 3, the decisive question is *which* regime's internal objective/logic that is the relevant yardstick. In that regard, it is difficult to come to any other conclusion than that it is the ETD's internal logic that is relevant in this case. Indeed, as already described above, there seems to be a presumption in favour of a finding of State aid when a relief is granted under Article 16 of the ETD. Not only the Commission's consistent practice in that regard speaks for such a conclusion, but also the incorporation of the State aid rule on overcompensation into Article 16(3) is evidence to that effect. The conclusion that it is the ETD's internal logic that guides the assessment of tax reliefs under Article 16 is moreover shared by Antón Antón and Villar Ezcurra.³⁴² Finally, if that was not the case, I find it hard to see, as will be shown below, why the Swedish CO₂ tax scheme involves State aid (or the Finnish energy taxation system for that matter).

6.3.1 The Swedish energy taxation system

As a starting point it should be emphasised again that it is evident that as long as biofuel producers are exempted from paying energy tax, the Swedish energy taxation system will involve State aid. That is why, as explained above, the Swedish government, when it searched for ways to have its CO₂ tax qualified as not entailing State aid, proposed to quit exempting biofuels from the energy tax and instead apply it equally on both conventional fuels and biofuel, on the basis of the respective fuels energy content. Yet as the logic of the ETD is to tax fossil fuels and biofuels equally, on the basis of volume, using the energy content as the basis for calculating the tax rate will inevitably result in (as most biofuels have lower energy content than its fossil counterpart) a lower energy tax rate for biofuels. Whether that is problematic

³³⁹ Cf *ANGED*, Opinion of AG Kokott (n 201), paras 88 and 89.

³⁴⁰ See *Micheau* (2015) (n 185), p 341f.

³⁴¹ See eg C-522/13 *Navantia* EU:C:2014:2262, paras 35-44. See also, to this effect, *Sierra* (n 236), p 90.

³⁴² See *Antón Antón and Villar Ezcurra* (n 29), p 63; *Antón Antón* (n 74), section 14.5.1.1 and 14.5.1.2.

from the point of view of State aid will be discussed in relation to the Finnish energy tax, given that it is currently levied on the basis of the respective fuels energy content.

As to the Swedish CO₂ tax, the Swedish government argued back in 2013 that the biofuel tax exemption was justified by “the nature or the overall structure of the system of which [it] form part.”³⁴³ The Swedish government clearly chose to “rely” on the third step rather than the second step as biofuels and fossil fuels are comparable under the ETD. That is to say, in the light of the objective of the ETD, ie taxing fossil fuels and biofuels equally on the basis of volume, it would be difficult to argue that biofuel producers and producers of conventional fuels are not in a legally and factually comparable situation. Yet, as stated above, the Swedish government argued that it was the objective/logic of the CO₂ tax that was relevant for the selectivity analysis.³⁴⁴ To me that would only have been correct if taxation of motor fuels would not have been harmonised. And if that would have been the case, that is to say, the objective/logic of the CO₂ tax was the relevant yardstick, it seems logical to me to argue that the measure is not even *prima facie* selective. Indeed, in light of the objective(s) of the Swedish CO₂ tax, fossil fuels and sustainable biofuels are arguably not in a factually and legally comparable situation, as only fossil fuels emit fossil carbon emissions, which is what the tax aims to deter due to its negative effect on the environment. This analysis seems consistent with the Court’s finding in *ANGED* and also with the Commission’s understanding of the case-law, as outlined in its Notice.³⁴⁵ This would equally have been the case if the ETD would have been revised according to the Commission’s proposal.³⁴⁶

However, now that taxation of motor fuels is harmonised and now that the ETD has not been revised, it is clear that granting tax reliefs to biofuels cannot be justified by the nature and logic of taxes introduced under the ETD, as the logic of the ETD is to tax all motor fuels equally on the basis of volume regardless of their environmental performance.³⁴⁷ In other words, granting tax reliefs to biofuels on environmental grounds cannot be considered internal to the logic underlying the ETD. It is thus clear that the ETD, in its current form, has a decisive impact on classifying the Swedish CO₂ tax scheme as including State aid.

6.3.2 The Finnish energy taxation system

As explained above in section 5.4, the Finnish government, equally, considers the difference in taxation between biofuels and fossil fuels entailed in its CO₂ tax scheme (as well as in its energy tax) to be justified by the nature and logic of that system. However, in contrast to the considerations just outlined for in relation to the Swedish CO₂ tax, it seems reasonable, from the point of view of the Finnish perspective, to put the focus on justification under step 3 also in a hypothetical situation where it is the objective of the Finnish CO₂ tax (and not the ETD) that is the relevant yardstick. Indeed, as will be remembered, the Finnish CO₂ tax does not,

³⁴³ Non-aid notification in SA.36972 Annex I (n 26), p 15.

³⁴⁴ See *ibid*, p 3.

³⁴⁵ See Notice on the notion of State aid (n 43), para 136.

³⁴⁶ See *ibid*, para 136.

³⁴⁷ Cf *Denmark* (n 305), para 44; *Antón Antón* (n 74), section 14.5.1.2.

contrary to the Swedish CO₂ tax scheme, have as its stated objective the promotion of biofuels, but rather to tax all fuels as neutrally as possible on the basis of the fuel's CO₂ emissions in a life cycle perspective.³⁴⁸ And from that perspective it would be difficult to argue that biofuels and fossil fuels are not in a comparable legal and factual situation, having regard to the objective of the Finnish CO₂ tax.

Moreover, a CO₂ tax, such as the Finnish one, whereby motor fuels, whether fossil or bio based, are taxed consistently on the basis of its emissions in a life cycle perspective indeed seems to follow the internal logic of such a tax. Of course, the division of sustainable biofuels into only two categories – where first generation biofuels are considered to emit 50 % less CO₂ than its fossil counterpart and second generation (advanced) biofuels are considered carbon neutral – can be accused of oversimplifying the emissions caused by different biofuels in a life cycle perspective. Yet as that, more or less, follows the logic of the RED and the fact that Member States are, in principle, free in determining the logic of its tax systems, it seems correct from that point of view to conclude that the Finnish CO₂ tax scheme does not entail any State aid. The same considerations apply in relation to the Finnish energy tax (provided that it was the logic of that tax that is relevant). Indeed, an energy tax whereby all fuels are taxed equally on the basis of its energy content clearly follows the logic of such a tax and accordingly does not involve any State aid.

However, it is to me difficult to arrive at the same conclusion when it is, as stated above, the objective/logic of the ETD that guides the selectivity analysis in relation to tax reliefs under Article 16. And as explained above in section 5.2.2, every differentiation in favour of biofuels in comparison with its fossil fuel counterpart, even above the minimum levels, falls within the scope of Article 16 of the ETD. The fact that the CO₂ tax does not have as its stated objective to promote biofuels must be considered irrelevant in this regard as it is the measures effects that matters.³⁴⁹ Even though the Finnish CO₂ tax is applied consistently and neutrally according to the logic of that tax, the result or effect of that application is that sustainable biofuels are subject to either a partial or a full exemption. Unless those tax reliefs would be adjusted back by another indirect tax or excise duty,³⁵⁰ so that biofuels and its fossil fuel counterparts are taxed similarly, per volume, a differentiation is created in the eyes of the ETD. And as the logic of the ETD is to tax all fuels equally, a lower tax rate for biofuels cannot, as stated above, be considered in line with that logic. Similarly, an energy tax which is levied on the basis of its energy content, which will have the result that biofuels are taxed at a lower rate than its fossil counterpart, will, in my opinion, face the same problem to be justified according to the internal logic of the ETD.

This finding is of course regrettable as the Finnish energy taxation system is indeed very sensible and should not, if judged according to its own logic, involve any State aid. However, now that the ETD, unfortunately, remain in force, I find it hard to come to another conclusion.

³⁴⁸ See RP 26/2012 (n 329), p 2.

³⁴⁹ See eg C-524/14 P *Hansestadt Lübeck* EU:C:2016:971, para 48.

³⁵⁰ Cf Article 4(2) of the ETD (n 28).

Having said that, why is it that the Commission nonetheless seems to have accepted the Finnish model and how should the Swedish government proceed now that the end of 2020 is only 20 months away? This will be discussed in the following.

6.4 Discussion – the ETD prevents Member States from designing well-targeted environmental taxes

So why has the Commission accepted the Finnish energy taxation system as not involving State aid? Needless to say this is not a question I can answer with certainty. Yet, I can, on the basis of the material available, try to make some assumptions. A preliminary observation is of course that my analysis may be wrong. That could very well be what the Finnish government (and the Commission) would say. However, for the reasons I have explained above, I do not see how another interpretation is possible. Yet the fact that the Commission, apparently, has accepted the model and the fact that the Finnish government, apparently, discussed the matter with the Commission for three years³⁵¹, puts the finger on at least two things. The first is that assessing the selectivity of (certain) tax measures, as has been illustrated in this thesis, is far from straightforward and involves, arguably, a great deal of subjectivity.³⁵² The second is that the ETD is old and outdated and that the Commission, for very good reasons, wish to see it revised. The latter point, I think, is particularly important in this regard. As has been shown above, it seems fully reasonable to conclude that the Finnish energy taxation system does not involve any State aid if assessed only on the basis of its own logic. That is to say, if one acted as if Article 16 of the ETD was not applicable and therefore was not able to “infect” the selectivity analysis of the Finnish energy and CO₂ tax schemes.

As a matter of fact, there are also indications in the Finnish preparatory works that Finland actually do *not* consider Article 16 of the ETD to be applicable in relation to its energy taxation system. Indeed, in explaining the ETD in RP 191/2018 and the possibility given under Article 16 (albeit without explicitly mentioning it) to grant tax reliefs to biofuels, the Finnish government states that “the tax relief may only be authorised for a limited time, so that the maximum time for the relief is six years at the time. Member States had the possibility to introduce an aid program during the years 2004-2012”.³⁵³ It then goes on by stating that:

[an] introduction at national level of an aid program enabled by the [ETD] and that is aimed at promoting biofuels *always presuppose* a State aid assessment (...) and accordingly that the Commission approves the aid measure beforehand. In Finland this procedure has been applied to biofuels used in certain demonstration projects.”³⁵⁴

³⁵¹ Email from Leo Parkkonen, Finnish Ministry of Finance, to author (2 May 2019).

³⁵² Cf *Heitkamp*, Opinion of AG Wahl (n 151), para 105; Monsenego (n 151), p 182.

³⁵³ My translation of “Skattenedsättningen kan beviljas endast tidsmässigt begränsat så, att maximitiden för nedsättning är sex år I sänder. Medlemsstaterna hade möjlighet att inför ett stödprogram under åren 2004-2012” at p 14 in RP 191/2018 (n 27) (the same statement was also made in RP 26/2012 (n 329), p 3).

³⁵⁴ My translation of “Ett nationellt införande av ett stödprogram som [ETD] medger och som är avsett att främja användningen av biodrivmedel förutsätter alltid ett förfarande för statligt stöd (...) och således också at kommissionen godkänner stödåtgärden på förhand. I Finland har detta förfarande tillämpats på biodrivmedel

The Finnish government accordingly seems to consider, first of all, that there is a time-limitation connected to the possibility to grant tax reliefs under Article 16. Without explicitly mentioning it, it is clear that the Finnish government in this regard is referring to Article 16(5) of the ETD. Article 16(5) stipulates to this end that the tax reliefs allowed for under Article 16(1) may be granted under “a multiannual programme by means of an authorisation issued by an administrative authority (...) [*but not for*] *more than six consecutive years.*”³⁵⁵ A period which, according to the second subparagraph of that article, may not be renewed after 31 December 2012. Interpreting this as a generally applicable time-limitation for the possibility to grant tax reliefs under Article 16(1), as the Finnish government seems to do, and which it does not seem to be alone in doing³⁵⁶, must however be considered erroneous. Indeed, there is no indication whatsoever that the Commission interprets Article 16(5) to that effect.³⁵⁷ On the contrary, Article 16(5) was, apparently, introduced back in 2003 to accommodate the needs of a particular Member State and is therefore not generally applicable.³⁵⁸ Yet given that that is how the Finnish government nonetheless seems to interpret the provision, indicates that it does not consider its tax reliefs to fall within Article 16 of the ETD. That conclusion is moreover supported by the second statement quoted above. Indeed, by stating that the introduction of an aid program *always presuppose* a State aid assessment, the Finnish government confirms, in my opinion, the position outlined for above, namely that a tax relief under Article 16(1) entails a presumption in favour of a finding of State aid for such reliefs. That conclusion, from the Finnish perspective, together with the example for when Article 16 *has* been relied on (ie support to biofuels used in demonstration projects) is tantamount to saying that Article 16 has *not* been applied in relation to its energy taxation system.

Another factor that speaks in favour of the conclusion that the Finnish government does not consider its tax reliefs to fall within the scope of Article 16 is connected to the verb “promote”. By designing its energy tax and CO₂ tax on the basis of neutral criteria, biofuels are not subject to lower taxation because they are explicitly promoted via a tax relief, but simply because that is the inevitable consequence of taxes levied on the basis of energy content and CO₂ emissions. Thus, as Article 16 is specifically aimed at granting tax reliefs to promote biofuels,³⁵⁹ the Finnish government can argue that Article 16 does not apply in their case as its energy taxation system involves no tax reliefs in the form of a derogation from a main rule. However, as has already been explained above it must be considered irrelevant whether a tax formally promotes biofuels or not. What matters is that the effect is that biofuels are subject to lower taxation than its fossil counterparts, regardless of the causes for that lower taxation.

som används i vissa försöksprojekt” at p 14 in RP 191/2018 (n 27) (the same statement was also made in RP 26/2012 (n 329), p 3).

³⁵⁵ Emphasis added.

³⁵⁶ See Karlsson (n 23), p 130.

³⁵⁷ The Commission never refers to this paragraph in its Decisions (see eg SA.48069 (n 19)) and I have found no support in the literature or anywhere else for this interpretation.

³⁵⁸ Interview with Susanne Åkerfeldt (n 306).

³⁵⁹ See recital 26 of the ETD (n 28).

That being said, to connect back to the initial question leading to this discussion, namely why the Commission seems to have accepted the Finnish model and why the ETD is of particular relevance in this regard. Knowing that this is rather speculative, it is plausible that the Commission has accepted the Finnish energy taxation system as it was “easier” to let a clearly neutral tax system, that on its own merits does not involve any State aid, pass, than to “ruin” such a tax system, that in all aspects is very good, on the basis of an old and outdated directive that the Commission wish to have revised.

However, if that is the case, why did the Commission continue to raise concerns when Swedish civil servants discussed a possible re-design of the Swedish energy taxation system in line with the Finnish model? I can again only speculate. From a background document from the Swedish Ministry of Finance it follows however that the Commission particularly had issues with the intended re-design of the energy tax. Contrary to the Finnish energy tax the Swedish energy tax, although levied equally on the basis of energy content for biofuels and its fossil counterparts, would maintain a difference in taxation between different fossil fuels.³⁶⁰ That is to say, the tax would not be entirely neutral in that diesel and its bio based substitutes (eg biodiesel) would still pay less in proportion to its energy content than petrol and its bio based substitutes (eg ethanol).³⁶¹ The advantage would then, however, not be given to biofuels in comparison with its equivalent fossil fuel, but rather to diesel fuels in comparison with petrol and the fuels that substitute it. Yet it is not entirely clear why the Commission had issues with this given the fact that Member States appears to be allowed to apply different tax rates on different fossil fuels, as long as they respect the minimum levels, without such differentiation being considered to constitute State aid in favour of the fossil fuel subject to the lower rate.³⁶² Natural gas is for example exempted from energy tax in Sweden (but complies with the minimum rate due to the CO₂ tax),³⁶³ without that being considered to constitute State aid in favour of natural gas. The rationale underlying this seems to be that fossil fuels do not compete with each other, but only with fuel that can substitute it directly.

It thus appears that if the Commission should accept the lower taxation of biofuels in comparison with its fossil fuel counterparts as not involving State aid, it does all of a sudden not accept that any difference in taxation exists between different fossil fuels. Instead the taxes has to be levied on the basis of the same neutral and objective criteria for all fuels as is the case with the Finnish energy taxation system. However, even if we assume that that is the case it does not change the fact that the Finnish energy taxation system, as shown above, nonetheless involves State aid. After all, the law is the law and it cannot be so that it is possible to disregard applicable legislation (in this case the ETD) in some cases, while not doing so in others, just because one system (the Finnish) is somehow “less” selective than another (eg the Swedish).

Having said that and turning instead to the situation in Sweden: how should one find a solution to the situation for high-blended and pure biofuels now that the situation is as it is? One answer

³⁶⁰ Ministry of Finance, Sweden (2 July 2015) (n 324), p 2.

³⁶¹ See prop 2017/18:1 (n 15), p 383.

³⁶² Cf Ministry of Finance, Sweden (2 July 2015) (n 324), p 5.

³⁶³ See paragraph 1, subparagraph 4a of the 2nd chapter of the LSE (n 306).

is of course to keep working for a revision of the ETD. For the reasons explained, this may however not come about as quickly as would be desirable. Another solution would be to try, again, to propose a re-design of the energy taxation system in line with the Finnish model, and this time with an energy tax that is truly neutral. However, given that I consider also such a tax system to involve State aid as long as the ETD remain in force, it is difficult to propose such a move. The situation would of course change if the Swedish government could get a formal decision from the Commission that such an energy taxation system does not involve State aid. However, in the absence of such a decision, the possibilities to use tax reliefs as a measure to promote biofuels even after 2020 seems, regrettably, more uncertain. Even though the Commission would most likely approve tax reliefs for high-blended and pure biofuels even after 2020, that will not be possible for food-based biofuels. That is unless the Commission changes its mind in that it will not only prolong the EEAG as such until end of 2022, which it recently announced it will do³⁶⁴, but also change the deadlines in the EEAG from 2020 to 2022.³⁶⁵

Either way, such a solution only postpones the real problem of finding a predictable solution for another two years. And given the urgency of the matter and the importance of creating long-term instruments that incentivises increased production of sustainable biofuels, that does not seem to be a satisfactory solution. It is therefore increasingly likely that high-blended and pure biofuels has to be included in the emission reduction obligation scheme. However, the obligation scheme then has to be adjusted to accommodate the peculiarities of such fuels, which otherwise will face serious problems to compete with low-blended biofuels. Indeed, when Germany introduced an emission reduction obligation in 2015 without taking high-blended biofuels into account, these fuels completely disappeared from the market.³⁶⁶ Given the importance of high-blended and pure biofuels for the ability to achieve a fossil free vehicle fleet, it is of course crucial that such a mistake is not repeated in Sweden. Such a scenario would moreover be detrimental not just to the investments made in infrastructure and vehicle fleets – such as buses used in many local public transport networks in Sweden which are running on high-blended and pure biofuels – but in particular to the overarching goal of reducing GHG emissions.³⁶⁷ How the continued viability of these biofuels will be safeguarded post 2020 is therefore of crucial importance, however that is achieved. In this regard it should be mentioned that the Swedish Energy Agency – which has been tasked with evaluating the emission reduction obligation, including how to best support high-blended and pure biofuels after 2020³⁶⁸ – recently has indicated that it considers tax exemptions, in principle, the most preferable

³⁶⁴ Press release, 'Commission to prolong EU State aid rules and launch evaluation' (7 January 2019) <http://europa.eu/rapid/press-release_IP-19-182_en.htm> accessed 18 May 2019.

³⁶⁵ See, in this regard, Ministry of Finance, Sweden (2019) (n 93).

³⁶⁶ Energimyndigheten, 'Förslag till styrmedel för ökad andel biodrivmedel i bensin och diesel' (ER 2016:30), p 20.

³⁶⁷ See prop 2017/18:1 (n 15), p 385.

³⁶⁸ Ibid, p 384.

solution for such biofuels, but that it nonetheless may become necessary (for the reasons given above) to include these fuels in the obligation scheme.³⁶⁹

Without going further into a discussion on the pros and cons of tax reliefs contra supply obligations,³⁷⁰ it can only be concluded that it is, needless to say, unsettling that the current legal framework prevents Member States from adopting, from a scientific point of view, the measures considered most suitable to reduce our emission of CO₂. After all, it has to be remembered that the clock is ticking and that limiting global warming to 1.5°C will require, according to the IPCC:

rapid and far-reaching transformations in energy (...) and infrastructure (including transport and buildings), and industrial systems (...). These systems transitions are unprecedented in terms of scale (...) and imply deep emissions reductions in all sectors, a wide portfolio of mitigation options and a significant upscaling of investments in those options (...).³⁷¹

If such a transformation is even doable within the existing economic framework is food for thought. However, what is clear is that, as of now, we need all the tools in the toolbox that can help decarbonise our economies. To this end, properly designed environmental taxes are of paramount importance and it is highly regrettable that an old and outdated directive is able to hinder that.

³⁶⁹ Energimyndigheten, 'Reduktionsplikt: Energimyndighetens kontrollstationsuppdrag' (power point presentation) <<https://www.energimyndigheten.se/globalassets/fornybart/hallbarabranslen/reduktionsplikt/reduktionsplikt-hearing-2019-05-10.pdf>> accessed 19 May 2019.

³⁷⁰ Cf section 2.4 above.

³⁷¹ IPCC, Summary for Policymakers (n 57), p 17.

7 Summary and conclusions

The purpose of this thesis was to study how the ETD influences the selectivity assessment of the taxation of biofuels in the Swedish and Finnish energy taxation systems. To achieve this purpose it was necessary, first, to investigate the selectivity criterion and how it is applied to tax measures – and particularly tax measures which objective is environmental protection. This was necessary as it appeared unclear how the ETD, which objective is not environmental protection, influenced the selectivity assessment of taxes, such as the Swedish and Finnish CO₂ taxes, which differentiate between fuels on the basis of their environmental performance. To fully understand the background to why Member States wish to promote biofuels, the thesis however started by outlining the Union’s climate policy framework, under which renewable energy, including biofuels, is promoted.

As was seen in that regard, Member States has primarily relied on biofuels to achieve the 10 % renewable energy target for the transport sector set out in the RED. To support biofuels, tax reliefs and biofuel supply obligations have been the two main instruments deployed in the different Member States. While the Commission in the early stages of development allowed Member States to apply both instruments at the same time, that was changed, as a general rule, in 2014 when the current environmental aid guidelines entered into force. As was briefly discussed in section 2.4, it can be questioned if it is desirable, from a climate policy perspective, with a prohibition on applying the two instruments at the same time. Indeed, as an obligation to blend biofuels into diesel and petrol will result in higher fuel prices, tax reliefs could complement such an obligation and counteract increased prices at the pump, thus creating a stronger overall incentive to increase the production and use of biofuels. However, the prohibition of a joint application of the two instruments is only a problem if the tax reliefs are considered to constitute State aid.

Before addressing that issue in more detail, chapter 3 was devoted to a brief introduction to State aid law and how the notion of State aid is defined in Article 107(1) TFEU. To that end it was described that the State aid rules were from the very beginning seen as a necessary component of the internal market project. It was feared that not controlling Member States’ abilities to grant State aid could lead to “subsidy-races” between Member States, which would undermine the creation and functioning of the internal market. The State aid rules, in that sense, has the same purpose as the EU as a whole, namely safeguarding the smooth operation of an internal market where undertakings can compete on equal terms. In determining whether a State measure constitutes State aid all the criteria in Article 107(1) TFEU has to be fulfilled. While supply obligations relatively easily can be designed to not involve State resources, which is the decisive criterion in determining whether such a measure constitutes State aid or not, the same cannot be said about tax reliefs. Indeed, in relation to tax reliefs the interpretation of the selectivity criterion, which is the decisive criterion in that regard, has proved far from straightforward.

As has been shown in this thesis, the purpose of the selectivity criterion is to determine whether any unjustified differential treatment between comparable undertakings is caused by a (tax)

measure. The three-step test serves in that regard as a tool to determining whether any such unjustified differential treatment (ie discrimination) is at hand. In this analysis, identifying the objective(s) underlying a tax regime is of crucial importance to the outcome of the selectivity analysis. Indeed, what the Court primarily seem to search for is coherence in a tax system, evaluating whether a given measure is applied consistently having regard to the underlying logic/objective of the system of reference. This is nonetheless a task marked by uncertainty and it can be very difficult to foresee from one case to another – particularly where there is no rule that formally derogates from a given system or main rule – whether a measure is selective or not.³⁷²

In determining whether a tax measure is selective, it has moreover been shown, despite some uncertainties in that regard, that it is possible to rely on environmental objectives to justify differential treatment of undertakings. However, as only objectives internal to a tax system may be relied on, that seems only possible if the environmental objective is integrated (ie internal) in the tax regime under consideration. That is to say, if a tax measure is based on policy objectives unrelated (external) to the broader tax system of which a given measure forms part, a selective advantage will most likely be found to exist. As has been argued by some, this approach is regrettable. Indeed, this has the consequence, first, to delimit Member States' possibilities to pursue permissible/legitimate policy objectives within a wider tax system, arguably leading to Member States' legislative technique gaining in importance in contradiction with the effects-based approach underlying Article 107(1) TFEU, and second, to blur the distinction between steps 2 and 3 of the three-step test.

As it is only a tax system's internal objectives/logic that may be relied on for the purpose of the selectivity analysis, the internal logic of the ETD has a decisive impact on the selectivity assessment of the Swedish and Finnish energy taxation systems. Indeed, as the Swedish and Finnish energy and CO₂ taxes are considered harmonised excise duties under the ETD, and the fact that any differentiation in tax level in favour of biofuels falls within the scope of Article 16 of the ETD, it is the internal logic of the ETD, and not the national tax systems, that guides the selectivity assessment. The internal logic of the ETD is in this regard to tax all motor fuels, whether fossil or bio based, equally, on the basis of volume rather than environmental performance. Consequently, granting tax reliefs to biofuels will constitute a derogation from that rule, which cannot be justified by the internal logic of taxes introduced to comply with the ETD. As was shown in relation to the Finnish energy taxation system, this finding is immaterial of the fact that biofuels are not formally promoted under a tax system. What matters is that the effects of a system is that biofuels are subject to a lower level of taxation than its fossil counterpart.

While it is, needless to say, regrettable that the ETD has not been revised so as to enable environmental taxes that are properly oriented towards environmental objectives to not constitute selective aid, one can only speculate why the Commission, despite my conclusion, seems to have accepted the Finnish model. In this regard the fact that the ETD is so outdated

³⁷² Cf *Gibraltar* (n 180); *Monsenego* (2019) (n 25), p 90.

and the fact that the Finnish energy taxation system is designed in a neutral manner are arguably relevant factors. As was discussed in section 6.4 above, it is plausible that it was “easier” for the Commission to let the Finnish energy taxation system “pass”, since it is designed in a neutral manner, than to let the ETD “ruin” the Finnish system. Whether that is the case or not is again only speculation. However, as has been shown in this thesis it is difficult to come to another conclusion than that granting tax reliefs to biofuels under Article 16 of the ETD is generally considered to constitute State aid. And as the tax reliefs given to biofuels, particularly under the Finnish CO₂ tax scheme, must be considered to fall within the scope of Article 16, it leads to the conclusion that also the Finnish energy taxation system involves State aid.

As neither the Swedish CO₂ tax scheme, nor the Finnish energy taxation system would, as I read the CJEU’s case-law, entail any State aid if assessed on the basis of their own logic (or the logic of an ETD revised according to the Commission’s proposal) it is evident that the current ETD has a decisive influence on the selectivity analysis in these cases. Given the urgency of the matter and the fact that high-blended and pure biofuels seems to be best supported via tax exemptions, rather than through a quota obligation as the Swedish emission reduction obligation scheme, it is imperative that the ETD is revised. Indeed, properly designed environmental taxes are an essential tool in the fight against climate change and it would be utterly unsettling if an old and outdated directive will continue to hinder that.

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