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Environmental tax as a measure for achieving sustainable development obligations in the EU

by

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Abbreviation list

AG	Advocate General
Art.	Article
Commission	European Commission
EAP	Environment Action Programme
EC Treaty	Treaty establishing the European Community
ECJ	Court of Justice of the European Union
EGD	European Green Deal
ETD	Energy Taxation Directive
EU	European Union
EU ETS	Emission Trading Scheme for greenhouse gases
EU ETS	European Emission Trading Scheme
EU2020	Europe 2020 Strategy
GAD	General Arrangements Directive
GBER	General Block Exemption Regulation
Guidelines	Guidelines on State aid for climate, environmental protection and energy
NDC	Nationally Determined Contribution
OECD	Organisation for Economic Co-operation and Development
Para.	Paragraph
SDGs	Sustainable Development Goals
TFEU	Treaty on the Functioning of the European Union
UN	United Nations
UNCED	United Nations Conference on Environment and Development
UNFCCC	United Nation Framework Convention on Climate Change
VAT	Value Added Tax
WCED	World Commission on Environment and Development

1 Introduction

1.1 Background

Sustainable development has recently gained attention with the introduction of the Sustainable Development Goals by the United Nation in 2015 and the[1] Paris Agreement on climate change, which was concluded in the same year. The Paris Agreement set out targets for environmental protection and the mitigation of climate change. As a result the European Union (EU) proposed a new environmental policy package in order to achieve the targets of the Paris Agreement and the Sustainable Development Goals. This policy includes new environmental tax measures to help achieve the targets.

The first environmental tax measure in the EU was in the field of energy. Energy taxation in the EU started in 1992 with the adoption of the directives on the taxation of mineral oils. The goal was to harmonise all energy taxation in order to take away distortions and improve the internal market. If every Member State had a different tax rate people would buy their energy products in the Member State with the lowest tax rate, because it would be cheapest there. This goal failed, but the Commission did achieve a minimum tax rate for mineral oils. The Commission attempted to include environmental considerations for the determination of the minimum rates. However, the rates were mostly defined by other factors, such as revenue and competition considerations.[2] On top of that, there were reduced rates and exemptions, for example, mineral oils used for airplane fuel were exempt. There was a clear disconnect between the EU's climate goals and the environmental tax policies.

At the same time as the mineral oil tax, the Commission proposed a CO_2 tax, which shows that the Commission did attempt to include environmental considerations in energy taxation. However, this CO_2 tax failed, because unanimity is necessary for tax decisions in the EU, and that unanimity could not be reached.[3] A decade after their adoption, the directives on the taxation of mineral oils were replaced by the Energy Taxation Directive.[4] This directive contained more environmental objectives, unfortunately the connection with environmental considerations was still not present. For example, the minimum tax rate on coal was lower than the minimum tax rate on less polluting energy sources.[5]

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[1] "Transforming Our World: The 2030 Agenda for Sustainable Development | Department of Economic and Social Affairs" (*United Nations*) <https://sdgs.un.org/2030agenda> accessed June 19, 2022; Conference of the Parties, Adoption of the Paris Agreement, Dec. 12, 2015 U.N. Doc. FCCC/CP/2015/L.9/Rev/1 (Dec. 12, 2015) https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf.

[2] A. Pirlot, "Exploring the Impact of EU Law on Energy and Environmental Taxation", in: C. HJI Panayi, W. Haslehner, E. Traversa (Eds.), Research Handbook in European Union Taxation Law (2020) Cheltenham, UK, p. 4-5.

[3] Ibid.

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

[5] Pirlot, (n.2), p. 5-6.

In order to achieve the new targets for sustainable development and climate change mitigation the EU needed to adapt their environmental tax legislation to include environmental objectives. Environmental tax measures can be a great tool for achieving sustainable development targets. However, that is not always the case, especially when the measures do not have the right balance between economic and environmental sustainability. This thesis will assess the following question:

What is the effect of the EU environmental tax policy on the achievement of international sustainable development obligations by the EU and its member states?

1.2 Aim

The aim of this thesis is assessing the balance between the different dimensions of sustainable development in EU Environmental Tax Law Policy and the corresponding Court of Justice of the European Union (ECJ) case law to determine if the EU policy has a positive or negative effect on the achievement of sustainable development commitments in the EU and its member states.

1.3 Method and material

In this research the legal-dogmatic research method will be used to assess the EU environmental tax legislation, the interpretation of this legislation by the ECJ and the resulting effects on the sustainable development obligations.

Materials used are ECJ case law on the compatibility of national environmental tax measures with state aid, fundamental freedoms or secondary EU law. This will be analysed together with primary and secondary EU law and international agreements on sustainability and climate change in order to determine the current legal framework on sustainable development and environmental taxation and the interpretation of current legislation by the Court. Other documents of the European Commission will be used in addition to this, such as proposals for amending legislation and guidelines on interpretation. To provide a broader perspective journals and books will be used as well.

1.4 Delimitation

This thesis is limited to the assessment of environmental tax measures within the EU and their interaction with international agreements on sustainable development and climate change. Other tax measures or non-fiscal environmental measures will nog be taken into account, unless they are relevant in a specific context.

1.5 Outline

Chapter 2 provides a definition of sustainability and sustainable development.

Chapter 3 includes an overview of the international and European sustainable development obligations.

Chapter 4 gives an overview of the EU legislation regarding environmental tax measures and the compatibility of nation tax measures with EU law.

Chapter 5 reviews the relevant case law of the ECJ on the compatibility of national environmental tax measures with EU law.

Finally, a conclusion is provided in chapter 6.

2 Sustainability and Sustainable Development

2.1 Background and Terminology

Sustainability, sustainable development and the sustainable development goals are each separate concepts and should not be confused.

In 1987 the World Commission on Environment and Development (WCED) published the report 'Our Common Future', also known as the Brundtland Report, which introduced the core principles of sustainable development and are still relevant today. The report defined sustainable development as: "development that meets the needs of the present without compromising the ability of future generations to meet their own needs".[6]

As a result of the Brundtland Report, in 1992 the United Nations held the United Nations Conference on Environment and Development (UNCED), which is also known as the earth summit, in Rio de Janeiro. During this conference the concept of sustainable development was discussed further and it was concluded that social, economic and environmental factors are interdependent and that they should be viewed together. For achieving progress in one of the sectors, action in the other sectors is necessary as well. Therefore sustainability cannot be viewed as separate from development and, instead, sustainable development should be the goal. For this new integrated approach, the right balance between economic, social and environmental objectives would be necessary. The UNCED resulted in many new achievements, such as the Commission for Sustainable Development and Agenda 21, which introduced the Millennium Development Goals.[7]

Sustainable development has three main aspects, economic sustainability, social sustainability and environmental sustainability. The balance between environmental and economic sustainability is especially important in the area of environmental taxation, and therefore it is valuable to review this balance and consider whether it is balanced correctly or if it has shifted too far in either direction.

It is easier to separate social sustainability from environmental sustainability, because the two have less overlap. Economic sustainability relates to the traditional economic theory of efficient use of resources, while at the same time recognizing the limited availability of natural resources. Environmental sustainability focuses on maintaining healthy ecosystems and ensuring the future availability of those natural resources. Sustainability is therefore essential for continued development.[8]

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[6] Report of the World Commission on Environment and Development, Our Common Future (1987).

[7] "Fit for 55" (*Consilium*June 21, 2022) <https://www.consilium.europa.eu/en/policies/green-deal/fit-for-55-the-eu-plan-for-a-green-transition/> accessed June 20, 2022.

[8] R. Goodland. "The Concept of Environmental Sustainability." Annual Review of Ecology and Systematics 26 (1995): 1–24. http://www.jstor.org/stable/2097196, p.2.

There is not one clear definition for sustainable development. As mentioned before, the Brundtland Report defines sustainable development as '"development that meets the needs of the present without compromising the ability of future generations to meet their own needs'. The World Wildlife Fund has a similar definition: "Improvement in the quality of human life within the carrying capacity of supporting ecosystems". The essence in each definition is the same: sustainable development is development that is socially sustainable and does not go beyond what the environment can carry. However, what exactly is meant by social sustainability remains unclear.[9]

Although the three dimensions of sustainability are intertwined and action in every dimension is necessary to achieve sustainable development, it can be difficult to find the right balance. To end poverty, hunger and inequality, increased economic growth appears to be the solution. However, according to Goodland, environmental sustainability does not allow for more economic growth.[10] The goal of environmental sustainability is to sustain natural resources and human life-support systems. This goal cannot be reconciled with economic growth, which requires even more resources, since the environment is already over its capacity. It is simply not possible to achieve economic sustainability goals, such as ending poverty, by increasing growth. This is not sustainable in the long term and would eventually lead to even more poverty and hunger, as natural resources would run out. For this reason environmental sustainability must be given priority. Economic and social sustainability can only be sustainable as long as they do not increase the strain on the earth's life-support systems. To achieve economic and social sustainability the focus should move toward redistribution instead of growth. It is unsustainable and unachievable for low-income countries to rise to the level of high-income countries. The wealth should be shifted instead from the high-income countries towards the low-income countries so as to bring them to the same level.[11]

The objective of environmental sustainability is to keep global life-support systems intact indefinitely so that human life can be maintained. To achieve this goal, natural resources must not be depleted and waste products should not accumulate.[12] Environmental sustainability can be defined as "maintenance of natural capital". This maintenance includes two fundamental aspects: the use of resources and the output of waste. Essentially, environmental sustainability sets constraints to four activities: the use of renewable and non-renewable sources, and the creation of waste and pollution.[13]

2.2 Different Models of Sustainability

The concept of sustainability as described in the Brundtland Report is fundamentally different from Goodland's understanding. The different concepts could be categorised as political-legal sustainability and theoretical

[9] Ibid, p. 3-4.
[10] Ibid, p. 5.
[11] Ibid, p. 4-5.
[12] Ibid, p. 6.
[13] Ibid, p. 10.

sustainability respectively.[14] The political-legal model is characterised by a holistic approach whereby the three pillars of sustainability are connected. The problems in each pillar are therefore connected as well, so to improve sustainability in one dimension, policy should take all three dimensions into consideration. For example, environmental protection policy should also take economic and social sustainability into account, because the lack of economic and social sustainability also contributes to environmental harm. Action in only one or two dimensions, but not the other, is therefore inefficient and will not lead to sustainability. Balance between the three dimensions is therefore essential.[15]

Theoretical sustainability takes a different approach, in which the three dimensions are not equal, as has been illustrated by Goodland. Environmental (or ecological) sustainability is considered as essential and the other dimensions cannot exist without it. Environmental sustainability is necessary in order to sustain life, because without it natural resources would eventually be depleted. Economic and social sustainability are of secondary importance, and they should be achieved within the limits of the environment and the earth's natural resources.[16]

It is important to recognise the differences between the two approaches, because they each call for a different approach in policy as well. Policy based on the political-legal approach should include a balance of actions in all dimensions of sustainability and would therefore be a more harmonised approach, while policy based on the theoretical model should prioritise environmental sustainability and limit the other dimensions to the capacity of the environment.

2.3 Environmental Tax Measures as a tool for sustainable development

Taxes are an important tool for achieving sustainable development. This idea was introduced by Pigou in 1912. Pigou stated that taxes should be used to correct external effects of the market. Environmental taxes should therefore be used to mitigate the negative effects of climate change and pollution.[17]

According to classical tax theory, taxes have four functions. The main function of taxes is collecting revenue to finance the government's budget. The second function is redistribution of wealth from high income to lower income individuals in order to decrease inequality. Tax also has a stabilising function, by lowering the tax burden when the economy is in recession and increasing tax rates when the economic situation has improved, the ups and downs in the economy will be less severe, and thus more stable). Finally taxes can be used to regulate behaviour. Increased tax rates on certain

[14] J. Pedroso & J. Kyrönviita, Chapter 16: A Pluralistic Approach to the Question How to Balance Different Objectives of Sustainable Development through Environmental Taxes within the Framework of EU State Aid Law in Tax Sustainability in an EU and International Context (C. Brokelind & S. van Thiel eds., IBFD 2020), Books IBFD.
[15] Ibid, para. 16.2.
[16] Ibid.
[17] A.C Pigou, The Economics of Welfare (Macmillan and Co. 1920).

products will. In turn, subsidies can create an incentive for people to purchase a certain product. This regulatory function can be useful for achieving policy goals. For example, to reduce the usage of fossil fuels, governments could raise taxes on non-renewable energy sources or impose a subsidy for using renewable energy. The usage of polluting energy would decrease, because of the higher costs, while renewable energy usage would become cheaper and therefore in higher demand.[18]

From an economic perspective, environmental protection measures are necessary because environmental damage is a negative externality of the market which cannot be solved by the market itself, because individuals and businesses are not willing to pay extra for reducing environmental damage, especially if they are not disadvantaged by this themselves. Government intervention is therefore necessary.[19]

There are two general approaches for government intervention. Governments could implement standards for environmental protection or to reduce environmental pollution and impose sanctions if those standards are not met. This is the "command-and-control" approach. Environmental taxes are part of the market-based approach. Under this approach the government also implements standards, but the difference is that businesses and individuals can choose any method for complying with the standard.[20] A good example for this method is emission trading schemes, which impose a limit on the amount of emissions, but it is up to the individual to choose the method for reducing their emissions. All environmental tax measures are market-based. The market based approach is similar to the polluter pays principle, because the external environmental costs will be charged to the producer of the environmental harm by using environmental taxes.[21]

This could also lead to an unwanted effect. Making polluters pay for the environmental damage they caused can result in them changing their behaviour by deciding to reduce their pollution. On the other hand, polluters could choose to not change their behaviour and simply pay the extra cost, which could lead to a ‘right to pollute’ for those willing to pay the price. Using taxes as regulatory measures does not necessarily lead to the intended behaviour change, which would also mean the achievement of the policy goals would be unsuccessful.[22]

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[18] D. Nerudová et al., Chapter 3: Tax Policy Areas and Tools for Keeping Sustainable Economy and Society in the EU in Tax Sustainability in an EU and International Context (C. Brokelind & S. van Thiel eds., IBFD 2020), Books IBFD, para. 3.1.
[19] P. Mastellone, The Emergence and Enforcement of Green Taxes in the European Union – Part 1, 54 Eur. Taxn. 11 (2014), Journal Articles & Opinion Pieces IBFD.
[20] Ibid.
[21] Ibid.
[22] A. Pirlot, Chapter 4: A Legal Analysis of the Mutual Interactions between the UN Sustainable Development Goals (SDGs) and Taxation in Tax Sustainability in an EU and International Context (C. Brokelind & S. van Thiel eds., IBFD 2020), Books IBFD, para. 4.2.2.

3 Sustainable Development Obligations

3.1 International Agreements

3.1.1 Sustainable Development Goals

The United Nations Sustainable Development Goals (SDGs) differ slightly from the concept of sustainable development as described by the Brundtland Commission. It includes the same three dimensions of economic, social and environmental sustainability, however, the SDGs also include other objectives, such as gender equality.[23] The UN introduced the Sustainable Development Goals in Agenda 2030 as a successor to the Millennium Development Goals.

The SDGs are not legally binding and they do not come with compliance or enforcement mechanisms. They could, however, be implemented into domestic laws and in some cases SDG provisions overlap with provisions of international treaties.[24]

Several international organisations, such as the United Nations (UN) and the Organisation for Economic Co-operation and Development (OECD) have recognized the importance of taxation for the achievement of agenda 2030 and the Sustainable Development Goals, mainly through revenue collection, but taxes could also play a larger role in achieving the SDGs as a regulatory measure.[25] Tax Laws can be designed with the primary goal of achieving regulatory objectives, such as the SDGs instead of revenue collection.

The regulatory function of taxation can be used for achieving SDGs by internalising the negative external effects of environmental harm. For example, environmental taxes could help achieve SDG 13 (taking urgent action to combat climate change) by discouraging behaviours that could be harmful to the environment.[26]

On top of that taxes can be used to encourage behaviour that is beneficial to the environment. For example, by implementing a tax reduction for renewable energy, which could also help achieve SDG 13.[27]

Tax measures can also negatively impact the achievement of the SDGs. For example, tax incentives for company cars can have a negative effect on the environment and therefore also the SDGs related to environmental protection.[28]

3.1.2 Paris Agreement on climate change

The United Nation Framework Convention on Climate Change (UNFCCC) is the main international agreement on climate action. The EU is a party to

[23] Ibid.
[24] Ibid, para. 4.3.1.
[25] Ibid, para. 4.2.2.
[26] Ibid.
[27] Ibid.
[28] Ibid.

the UNFCCC alswel as nearly every country in the world. The UNFCCC signatories have come together regularly since its adoption in 1992, which has resulted in several climate agreements. The most important ones are the Kyoto Protocol and the Paris Agreement.

The Kyoto Protocol, which expired in 2020, introduced the first legally binding emission reduction targets.[29]

In 2015 the parties to the UNFCCC adopted the Paris Agreement on climate change, which is legally binding and aims to keep global warming to no more than 2 degrees Celsius above pre-industrial levels, with efforts made to keep it to no more than 1.5 degrees. Although there is a common target, each nation decides its own nationally determined contribution (NDC), in which its national goals to contribute are laid out.[30]

In 2020 the European Council submitted the EU's NDC, which also applies to its member states, to the UNFCCC. The NDC contains the target for the EU and its member states to reduce emissions. The EU NDC contains the target of reducing greenhouse gas emissions by at least 55% compared to 1990 before 2030.[31]

3.2 EU Environmental Policy

3.2.1 Background of previous environmental policies

In 2010 the European Commission introduced the Europe 2020 Strategy (EU2020) as a successor to the Lisbon Strategy, which had ended that year. The EU2020 set targets aimed to promote "smart, sustainable, and inclusive" growth, to be achieved in 2020.[32] Sustainable development is an important aspect in the EU2020, however, it is clear that priority should be given to growth, which should be 'smart, sustainable and inclusive'. Sustainable growth is described as: "promoting a more resource efficient, greener and more competitive economy."[33] The importance of economic growth can be explained by the history of the EU2020. It was implemented in 2010 as a response to the 2008 financial crisis. Although the focus of the EU2020 was on economic growth, environmental sustainability has been taken into account as well and there are still several targets in the environmental dimension, such as the reduction of greenhouse gas emissions and the increase of renewable energy usage. In order to achieve the targets a market-based approach was recommended, which includes the

[29] Kyoto Protocol to the United Nations Framework Convention on Climate Change, (FCCC/CP/1997/L.7/Add.1), https://unfccc.int/documents/2409.
[30] F. Kokotovic & P. Kurecic and T. Mjeda, 2019. "Accomplishing the Sustainable Development Goal 13 - Climate Action and the Role of the European Union," Interdisciplinary Description of Complex Systems - scientific journal, Croatian Interdisciplinary Society Provider Homepage: http://indecs.eu, vol. 17(1-B), pages 132-145.
[31] "Fit for 55" (n. 7).
[32] EUROPE 2020: A strategy for smart, sustainable and inclusive growth, COM/2010/2020 final, available at https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A52010DC2020 (accessed 20 June 2022).
[33] Ibid.

use of tax policy.[34] The 7th Environment Action Programme (EAP)[35] built further on the environmental targets of the EU2020 and introduced more targets for environmental sustainability, also to be reached in 2020. The EAP states that to achieve the targets there is a requirement for phasing out environmentally harmful subsidies at Union and Member State level and increasing the use of market-based instruments, such as taxation policies.[36]

The targets of the EU2020 and the EAP should have been reached in 2020, however, there have been mixed results. Although the EU2020 was aimed at increased coordination between member states, this seems to not have been achieved. The EU as a whole has certainly made progress, but there still seems to be a lack of coordination between individual member states. While some have made great progress, others have moved backwards. The worst results have been in the environmental targets, which have not been reached in any member state.[37]

3.2.2 Climate and environmental policy framework

3.2.2.1 European Green Deal

In 2019 the European Commission presented the European Green Deal (EGD), a roadmap with actions to make the European Union more sustainable. The goal is to reduce net greenhouse gas emissions by 55% before 2030 and to become the first climate neutral continent by 2050. To reach these goals the Commission has already proposed many policy changes, including amendments to the Energy Taxation Directive, to increase sustainability.

The European Green Deal (EGD) is the new strategic policy for sustainable growth in the EU, succeeding the Lisbon Strategy and the EU2020, introduced in 2019.

More attention is given to environmental sustainability, which was almost completely lacking in the Lisbon Strategy and insufficient in the EU2020. Fighting climate change and becoming climate neutral are the key elements of the EGD.

3.2.2.2 Fit for 55

This NDC was adopted in 2021 as the Fit for 55 package, which is a part of the EGD. The Fit for 55 package proposed several changes to the system of environmental tax measures in the EU. The following proposals relating to tax measures are included in the Fit for 55 package:

- Changes to the EU emission trading system
- Revision of the renewable energy directive
- Revision of the energy taxation directive

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[34] Ibid.
[35] Decision No 1386/2013/EU of the European Parliament and of the Council of 20 November 2013 on a General Union Environment Action Programme to 2020 'Living well, within the limits of our planet' (OJ L 354, 28.12.2013, p. 171).
[36] Ibid, para. 84.
[37] W. Becker, and others, (2020). Wrapping up the Europe2020 strategy: A multidimensional indicator analysis. *Environmental and SustainabilityIndicators*, 8(2020), https://doi.org/10.1016/j.indic.2020.100075, para. 7.

- Carbon border adjustment mechanism.[38]

As part of the Fit for 55 package, the EU is striving to reform its legislation relating to the environment, energy, and transportation in order to bring them into conformity with its 2030 and 2050 goals. The package also contains a number of additional initiatives.

3.2.3 Energy Crisis

As a reaction to the energy crisis resulting from the Russian invasion in Ukraine the EU introduced the REPower EU plan in May 2022. The plan includes proposals for alternative energy sources, such as increasing its renewable energy production by speeding up the existing plans. However, the REPower EU plan also includes polluting energy sources, such as coal, which was supposed to be phased-out already as was agreed upon in the Paris Agreement.[39]

[38] "Fit for 55" (n. 7).
[39] "Policies & Action" (*Policies & action | Climate Action Tracker*) <https://climateactiontracker.org/countries/eu/policies-action/> accessed June 22, 2022.

4 Legal Framework for the compatibility of Environmental Tax Measures with the EU internal market

4.1 Definition of Environmental Tax Measures

First a distinction needs to be made between environmental tax measures and non-fiscal environmental measures. The ECJ stated two differences between a market-based measure and a tax measure in the *Air Transport Association of America and Others* case[40] to assess whether the European Emission Trading Scheme (EU ETS) was a tax or a market-based measure. The EU ETS is a measure which has created emission 'allowances', which represent a certain amount of CO_2 that a company can produce. Companies can buy or sell allowances to adapt to their current level of CO_2 emissions.

The Court classified the EU ETS as a non-fiscal measure, based on the following characteristics: The scheme was not aimed at generating revenue and there was no tax base or tax rate established. Therefore it would be difficult to determine the price of the emission allowances in advance, since it would be dependent on the market price.[41] AG Kokott also noted that a lot of the emission allowances were distributed for free, which pointed to it being a non-fiscal measure.[42]

The distinction between fiscal and non fiscal measures is not always clear. The EU ETS, for example, has changed over the years and based on the characteristics mentioned by the Court in the A*ir Transport Association of America and Others* case it could now be considered a fiscal measure. This is because fewer allowances are given away for free and the plan is to decrease this number even further. The price stability of the allowances has been improved as well, which means that it could be possible to determine the price in advance. This situation shows that differentiating tax measures from market-based measures can be difficult and they could change over time. It is, however, unlikely that the ECJ will qualify the EU ETS as a tax in the future, because of the legal consequences of this decision. Fiscal measures require a different legislative procedure than non-fiscal measures. A different classification by the ECJ would mean that the, now fiscal, measure is not adopted by the right procedure and will therefore not have a valid legal basis.[43]

Secondly, the fiscal measure must be "environmental". There is not just one definition of what an environmental measure is. On top of that, there are

[40] Judgement of 21 December 2011, *Air Transport Association of America and Others v Secretary of State for Energy and Climate Change*, C-366/10, EU:C:2011:864.
[41] Ibid, para. 143.
[42] Opinion AG Kokott in *Air Transport Association of America and Others v Secretary of State for Energy and Climate Change* C-366/10, EU:C:2011:637.
[43] Pirlot, (n.2), p. 8.

several other terms that are used interchangeably, such as “eco-taxes”, “green taxes” and “environmentally related taxes”, however, they do not necessarily have the same definition. The lack of a common definition can lead to legal uncertainty, because the scope of legislation using any of these terms is unclear. Because of this unclear definition, oftentimes measures will be considered environmental tax measures when they have no environmental protection objective or when they should not be considered as fiscal measures.[44]

EU Member States have to collect data on environmental taxes every year, which will be used for creating estimates.[45] For this purpose, the EU and OECD created a clear definition of environmental taxes, to make sure countries collect the correct data for statistical analysis. This definition states environmental tax measures as: “A tax falls in the category environmental if the tax base is a physical unit (or a proxy for it) of something that has a proven specific negative impact on the environment, when used or released”.[46] This definition works well for its purpose, which is statistical analysis. However, it is important to keep in mind that under this definition an environmental tax measure could actually have a negative effect on environmental protection.[47] For example, energy taxation is always considered environmental taxation, because its tax base, energy production, is regarded as having a negative effect on the environment. The actual effect of a measure on the environment is irrelevant.[48] The ETD only requires a minimum rate of taxation. Member States could therefore choose to levy a higher tax on renewable energy, while only imposing the minimum tax rate on a more polluting source of energy, such as coal. This would create an incentive to consume more coal-fueled energy sources, which has a negative impact on the environment.[49] On the other hand, there are also taxes with no polluting tax base, which do have an environmental protection objective, for example by giving a tax incentive on a product with a smaller environmental impact.[50]

The purpose of environmental taxation is to discourage environmental damage and to serve as an incentive for behavioural change.[51] This purpose is not reflected in this definition. It seems as if the EU has chosen for a definition that allows for the main purpose of revenue collection with some possible environmental benefits, instead of having environmental protection as their main objective.

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[44] F. Pitrone, “Defining “Environmental Taxes”: Input from the Court of Justice of the European Union” (2015) Bulletin for International Taxation 58, p.58.
[45] Regulation (EU) No 691/2011 of the European Parliament and of the Council of 6 July 2011 on European environmental economic accounts, OJ L 192, 22 July 2011, p. 1, see art. 1 & 2.
[46] L. Jarass & G. M. Obermair, “Manual: Statistics on Environmental Taxes”, commissioned by European Commission, 28 July 1996.
[47] Pirlot, (n.2), p. 23-24.
[48] V. Musardo, “Green Deal and Incentive Effect: What Is Truly Environmental Aid?” 2021 Eur. St. Aid L.Q. 217 (2021), p. 221.
[49] Pitrone, (n. 44), p. 61-62.
[50] Ibid, p. 60-61.
[51] Ibid, p.61.

A definition that fits better with the purpose of environmental taxation can be found in the General Block Exemption Regulation (GBER). Article 2(119) states that:

"Environmental tax means a tax with a specific tax base that has a clear negative effect on the environment or which seeks to tax certain activities, goods or services so that the environmental costs may be included in their price and/or so that producers and consumers are oriented towards activities which better respect the environment."

The ECJ has given a definition of an environmental tax measure in relation to excise duties in the case *Transportes Jordi Besora SL.* The Court stated that: "… a tax … could be regarded as being itself directed at protecting the environment … only if it were designed, so far as concerns its structure, and particularly the taxable item …, in such a way as to dissuade taxpayers from using" certain energy products considered harmful to the environment.[52]

4.2 Sustainable Development and the EU Internal Market

Sustainable development has played an important role in increasing the need for coordination between EU member states in different policy fields, including tax. The idea of using tax as a tool for achieving environmental sustainability has been gaining more attention recently. The EU has implemented several policies for sustainable development, which have required a more coordinated approach between Member States.[53]

Article 26(2) of the Treaty on the Functioning of the European Union (TFEU) defines the EU internal market as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties'.

The objective of the internal market is the elimination of trade barriers between Member States in order to increase economic prosperity. It is important to recognise that the internal market is an instrument for achieving the EU objectives, not an end in itself. There are other means to achieve these goals as well, such as the economic and monetary union.[54]

Since the Amsterdam Treaty, environmental protection has become a fundamental goal of the EU, which was incorporated in Articles 2 and 6 Treaty establishing the European Community (EC)[55]. Article 2 EC stated the objective of a "high level of protection and improvement of the quality of the environment". This put environmental protection at the same level of importance as economic objectives. Environmental protection requirements must be included into all Community policies and actions, according to Article 6 TFEU.

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[52] Judgement of 27 February 2014, *Transportes Jordi Besora SL v. Generalitat de Catalunya*, C-82/12, EU:C:2014:108, para 32.
[53] Nerudová (n. 18).
[54] M. Wasmeier, 'The Integration of Environmental Protection as a General Rule for Interpreting Community Law', (2001), 38, Common Market Law Review, Issue 1, p. 159-160.
[55] Article 6 EC is the current Article 6 TFEU.

Environmental protection objectives may or may not always be compatible with economic goals. If the interpretation rule drawn from Article 6 TFEU is implemented in isolation without regard for other principles and objectives, the Treaty's economic goals may be overlooked.[56]

Environmental protection is a core principle of the European Union. Article 11 TFEU states: ‘environmental protection requirements must be integrated into the definition and implementation of the Union’s policies and activities, in particular with a view to promoting sustainable development’. This provision is also known as the integration clause. The principle of integration, as a general principle of Community law, must be taken into consideration whenever a rule of Community law is to be interpreted, especially when the rule's phrasing is susceptible to many interpretations or when there is a gap to be filled.

The environmental protection principle can also be found in Article 3(3) Treaty on the European Union (TEU), which states: 'The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.'

These treaty provisions create a duty for the EU and its member states to commit to environmental protection. Environmental protection is put on the same level of importance as economic objectives and there should be a balance between the two at the core of the internal market.[57] This reasoning is similar to the principle-legal model of sustainability, which requires a balance between the three dimensions, and especially between economic and environmental sustainability.

The unanimity requirement to adopt a tax measure in the EU has made it difficult to implement environmental tax policy. It can sometimes be easier to adopt non-fiscal measures, which could reach the same goals as tax measures. Instead of a CO_2 tax, the Commission has implemented an Emission Trading Scheme for greenhouse gases (EU ETS), for which only a qualified majority was required.[58] This unanimity requirement has resulted in a lack of effective environmental tax measures and at the same time a mismatch between the environmental tax measures and the market-based measures. For example, the Energy Taxation Directive and the EU ETS Directive sometimes “overlap” which creates a double tax burden but in other cases there is a gap which leads to no environmental taxation.[59]

During the integration process of the European Union, tax harmonisation has always been considered as crucial for the creation of the internal market. However, this harmonisation goal is still not reached, because national politicians perceive being able to create their own tax policies as an

[56] Wasmeier, (n. 54), p.165-166.
[57] R. Leal-Arcas, and others, 'Green Bills for Green Earth: How the International Trade and Climate Regimes Work Together to Save the Planet', (2022), 31, European Energy and Environmental Law Review, Issue 1, pp. 19-40, p.21.
[58] Pirlot, (n.2), p. 9.
[59] Ibid.

important part of their national sovereignty, which they are not willing to give up on.[60]

Non-harmonised national tax measures could create barriers to the internal market or distort competition. For example, one member state implementing higher tax rates for polluting products could restrict the free movement of goods, because of the extra cost imposed on certain goods. On the other hand, incentives in the form of lower tax rates or subsidies could favour certain undertakings over others, which could be considered state aid.

In recent years this view on tax harmonisation has slightly changed as a result of the increased base erosion and profit shifting, which was caused mainly by the increased globalisation in combination with the lack of coordination between tax systems. The erosion of the tax base and the following decrease of revenue has given Member States an incentive for coordination between tax systems.[61]

4.3 Compatibility of national environmental tax measures with the internal market

4.3.1 Compatibility of national environmental tax measures with the internal market

Due to the lack of harmonisation in EU tax law, the ECJ plays a large role in the assessment of the compatibility of national tax measures with EU law. Member states have a large discretion for making their own tax laws, which is only limited by distortions of competition or the restriction of the fundamental freedoms. The exception is the areas where there is harmonisation: indirect taxes and energy taxation.

4.3.2 State Aid

The general prohibition against state aid is stated in article 107(1) of the Treaty on the Functioning of the European Union (TFEU). This article states that:

"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."

In order to determine if a measure is state aid three conditions have to be met, which follow from article 107(1). The first condition that must be met is distortion of competition. The second is state origin, which means that state resources have to be used. The last condition for state aid is that certain undertakings have an advantage due to the measure, which others do not have. If the measure is applied to all undertakings equally in a jurisdiction there is no state aid. In conclusion, a measure can be classified as state aid if

[60] Nerudová (n. 18).
[61] Ibid.

it distorts competition, uses state resources and creates a selective advantage.[62]

Three factors should be considered while determining material selectivity. The Court first has to determine the system of reference, which includes the main components of the tax structure. Then the Court needs to determine if the tax measure in question constitutes a derogation from the system of reference. If this is the case, the derogation could be justified by the nature or the general scheme of the tax system.[63]

This assessment can be found in the Adria-Wien Pipeline case, in which the Court clarifies the process for determining a tax measure state aid compatible with the internal market, which is stated in Article 107 TFEU. First, the Court notes that the Commission has a duty to monitor aid and also has the competence to declare aid incompatible with the common market. To aid this process, Member States are required to inform the Commission on any plans regarding the granting or altering of aid. Member States are not allowed to implement the proposed measure until the Commission declares the aid compatible with the internal market.[64]

National courts can classify a tax measure as state aid, but they cannot determine whether the aid is compatible with the internal market. This is an exclusive responsibility of the Commission and the Commission's decision regarding the compatibility of aid measures can only be reviewed by the Court of Justice.[65]

Then the Court states that the prohibition of State aid is "neither absolute nor unconditional". The Commission has a wide discretion to derogate from the general prohibition and declare aid compatible with the common market. This discretion follows from Article 107(3), which states certain types of aid that may be compatible with the internal market.[66] Aid with a purpose of environmental protection is considered as such, which is stated in the Guidelines on State aid for climate, environmental protection and energy (Guidelines) and the General Block Exemption Regulation (GBER).[67]

The GBER includes categories of aid which are automatically declared compatible with the internal market. One of the categories is environmental tax measures as long as they fulfil the condition of the ETD. When there are

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[62] E. Ferreiro Serret, "Taxes with Environmental Purposes and State Aid Law: The Relevance of the Design of the Tax in Order to Justify Their Selectivity", in: Pasquale Pistone & Marta Villar Ezcurra, Energy taxation, environmental protection and state aids: tracing the path from divergence to convergence (IBFD 2016), pp. 245-270, para. 11.1.1.
[63] 2014 Draft Notice on the notion of State aid pursuant to Article 107(1) TFEU, available at http://ec.europa.eu/competition/consultations/2014_state_aid_notion/index_en.html , para. 128.
[64] Judgement of 8 November 2001, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirektion für Kärnten*, C-143/99, EU:C:2001:598, para. 23-25.
[65] Ibid, para. 29.
[66] Ibid, para. 30.
[67] Guidelines on State aid for climate, environmental protection and energy 2022, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.C_.2022.080.01.0001.01.ENG&toc=OJ%3AC%3A2022%3A080%3ATOC; Commission Regulation (EU) 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, OJ L187 (2014).

conflicting interest in the assessment of whether a tax measure is included in the scope of the GBER the commission applies the "refined economic approach" which, requires the balancing of the positive and impact of the aid in reaching an objective of common interest against its potentially negative side effects, which is the distortion of competition.[68]

In the case *Spain v Commission* the Court reiterates that the Commission has a lot of discretionary power in determining aid compatible with the internal market. The Commission does, however, have to follow their notices and guidelines in that specific area as long as they are not in conflict with the Treaty provisions. This means that the Guidelines on environmental aid are applicable.[69]

4.3.3 Fundamental Freedoms

The free movement of goods provisions are only applicable when there is no secondary law clarifying the issue.[70]

The provisions on the free movement of goods can be found in articles 28, 30, 34, 35 and 110 TFEU. There are three categories of barriers to the free movement of goods:

- Charges having an effect equivalent to that of customs duties (art. 28(1) amd 30 TFEU).
- Measures having an effect equivalent to quantitative restrictions (art. 34 and 35 TFEU)
- Internal Taxation (art. 110 TFEU)[71]

There are different rules for application for each of these categories. A tax measure can only fall within one category at a time.[72]

The first category is the prohibition of charges having an equivalent effect to customs duties. This barrier is not defined anywhere in the TFEU so the definition has been established by the ECJ. The Court has defined it as:

"any pecuniary charge, however small and whatever its designation and mode of application, which is … unilaterally imposed on domestic or exported goods by reason of the fact that they cross a frontier of one of the Member States and which are not customs duty in the strict sense."[73]

There are several types of national environmental tax measures that could be considered as charges having an equivalent effect to customs duties, such as a tax on the use of pipelines and the taxation of waste exportation.[74]

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[68] J. Englisch, Energy Tax Incentives and the GBER Regime (October 11, 2016). Villar Ezcurra (ed): State aids, Taxation and the Energy Sector, Thomson Reuters-Aranzadi, 2017, Available at SSRN: https://ssrn.com/abstract=2924505.
[69] Judgement of 13 February 2003, *Kingdom of Spain v Commission of the European Communities*, C-409/00, EU:C:2003:92.
[70] Judgment of 20 February 1979, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein*, C-120/78, EU:C:1979:42.
[71] N. de Sadeleer, "Environmental Regulatory Autonomy and the Free Movement of Goods" (2013) 1 Jean Monnet Working Paper Series – Environmental and Internal Market, p. 3-5.
[72] See Judgement of 2 August 1993, *Celulose Beira Industrial SA v Fazenda Pública*, C-266/91, EU:C:1993:334, para 9.
[73] Judgement of 2 April 1998, *Outokumpu Oy*, C-213/96, EU:C:1998:155.
[74] Sadeleer (n. 71), p. 7.

The second category is the prohibition of measures having an effect equivalent to quantitative restrictions. This category is very broad and includes any rules enacted by a Member State which could hinder trade in the internal market. This does not include tax measures, but other regulations, such as product standards. Since the case law in this thesis only consists of cases concerning tax measures, this provision is not relevant.

The last category can be found in article 110 TFEU. This article prohibits Member States from imposing "on the products of other Member States any internal taxation … in excess of that imposed directly or indirectly on similar domestic products" or "of such a nature as to afford indirect protection to other products".

The scope of this article is very wide and it includes discriminatory taxation on similar products as well as on 'other' products, which means products that are substitutable. A tax measure can thus be considered as internal taxation if it imposes a higher level of taxation on imported products, which are similar to domestic products. If there is no similarity, but the imported product and the domestic product compete with each other, article 110 TFEU is also applicable.[75]

There are three possible exceptions to prohibition of charges having an equivalent effect to customs duties. In those situations, the tax measure will not be considered as a charge having an equivalent effect. These exceptions follow from case law.

"if it relates to a general system of internal dues applied systematically and in accordance with the same criteria to domestic products and imported products alike …, if it constitutes payment for a service in fact rendered to the economic operator of a sum in proportion to the service…., or again, subject to certain conditions, if it attaches to inspections carried out to fulfil obligations imposed by Community law"[76]

The second two exceptions are almost never applied, only in very exceptional circumstances, which fall outside of the scope of this thesis.[77]

The first exception, regarding a general system of exemptions, is similar to the exception to article 110 TFEU: Article 110 TFEU does not preclude Member States from imposing differing tax rates on similar products if they are designed to accomplish legitimate economic and social objectives. The tax measure must be part of a general tax scheme which does not discriminate between imported and domestic products and if the different rate is objectively warranted by the objective pursued by the scheme. The measure cannot discriminate between imported and domestic products.[78]

The objective that is pursued by the tax measure has to be compatible with the requirements of the TFEU and secondary law. The Court has stated that environmental productions can be such an objective.[79]

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[75] Ibid, p.9-11.
[76] Judgement of 27 September 1988, *Commission of the European Communities v Federal Republic of Germany*, C-18/87, EU:C:1988:453, para. 6.
[77] Sadeleer, (n. 71), p.8.
[78] Ibid, p.13.
[79] *Celulose Beira Industrial*, (n. 72), para. 33.

A restriction to the freedom to provide services can be justified based on environmental protection according to article 52(1) TFEU. This is only possible if "the relevant measure is appropriate to ensuring the attainment of the objective in question and does not go beyond what is necessary to attain that objective"[80]

The freedom to provide services can be found in articles 56-62 TFEU and includes all services which are normally provided for remuneration. Member States are prohibited from implementing tax law which would create a higher cost for foreign service providers and would thus give an advantage to domestic service providers. The persons need to be in an objectively comparable situation. Generally, residents and non-residents are considered to not be in an objectively comparable situation.[81] However, the Court has stated that the specific characteristics of the relevant tax must be taken into account. A difference in treatment between residents and non-residents may constitute a restriction on the freedom to provide services, where there is no objective difference in the situation, with regard to the tax levy in question, which would justify different treatment between the various categories of taxpayer.[82]

4.3.4 Secondary Law

There is only one environmental tax harmonisation measure, the Energy Taxation Directive (ETD).[83] The ETD establishes low-level required minimum taxation and exempts intensive energy users from taxation. The current version of the ETD is incompatible with global climate change targets, because it discriminates against renewable energy sources. This is due to the fact that all energy sources, including polluting sources, are taxed at the same rate as renewable energy sources, but because the rate is dependent on volume, products with lower energy content are subjected to a higher tax burden. This system thus favours energy production that is more harmful to the environment.[84]

Another important directive in the field of energy taxation is the Directive for the promotion of energy from renewable sources.[85]The Directive establishes binding EU and national targets for the use of renewable energy sources. It establishes a decentralised system in which the EU sets mandatory targets for increasing renewable energy use, but member states decide how to meet those targets. Member states are urged to establish and execute national renewable-energy support programmes in order to meet their national goals. Other than the Energy Taxation Directive, the

[80] See Case Judgement of 30 January 2007, *Commission of the European Communities v Kingdom of Denmark*, C-150/04 EU:C:2007:69, paragraph 46.
[81] See Case Judgement of the Court of 14 February 1995, *Finanzamt Köln-Altstadt v Roland Schumacker*, C-279/93, EU:C:1995:31.
[82] Judgement of 17 November 2009, *Presidente del Consiglio dei Ministri v Regione Sardegna*, C-169/08, EU:C:2009:709, para. 35.
[83] Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.
[84] D. Deák, 'Environmental Tax Harmonization and Competition-Centred Legal Practice of EUCJ', (2017), 26, EC Tax Review, Issue 6, p. 307.
[85] Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC.

Renewable Energy Directive is not considered as harmonised in the area of tax, which means that the framework of the fundamental freedoms applies for determining the compatibility of national tax measures.[86]

The General Arrangements Directive (GAD) concerns the harmonisation of excise duties.[87] Environmental tax measures are often indirect taxes, which means they need to comply with the GAD.

[86] A. Steinbach, & R. Brückmann, (2015). Renewable Energy and the Free Movement of Goods. SSRN Electronic Journal. 10.2139/ssrn.2562392, para. 3.1.

[87] Council Directive 92/12/EEC of 25 February 1992 on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products; Council Directive 2008/118/EC of 16 December 2008 concerning the general arrangements for excise duty and repealing Directive 92/12/EEC.

5 Procedural Framework for the compatibility of Environmental Tax Measures with the EU internal market

5.1 Introduction

In this chapter an overview is provided of ECJ case law on environmental tax measures of EU member states and their compatibility with EU law. The legal system which the ECJ uses has been discussed above. The question that is answered in this chapter is whether the different dimensions of sustainability are in balance in the ECJ's assessment and what this means for environmental sustainability targets in the member states.

5.2 State Aid

5.2.1 Introduction

In this first group of cases the environmental tax measures are assessed in the state aid framework. At first the environmental aspect of a tax measure could only be taken into account in the assessment of the compatibility of state aid with the internal market. Environmental considerations of the measure were not taken into account for the qualification of a measure as state aid.[88]

5.2.2 Compatibility with the internal market

The first case regarding state aid is the Adria-Wien Pipeline case.[89] This case concerned an energy taxation rebate measure in Austria. This measure was part of an energy tax scheme for improving environmental protection by reducing harmful energy consumption. The Court stated first that national measures which provide an energy tax rebate, which applies equally to all undertakings in a jurisdiction, are not state aid.[90] In this case the measure was only applicable to manufacturers of goods. The court found no justification in the general scheme, because suppliers of goods were not more affected by the energy tax, so there was no reason to only grant them the rebate.[91]

Energy consumption by goods manufacturers is equally damaging to the environment as the energy consumption by service suppliers. The environmental objective of the national tax measure was therefore also not a justification for the differential treatment of service providers. Because the national tax measure is not justified by the nature or general scheme of the system, the tax rebate will be classified as state aid.[92]

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[88] Pedroso & Kyrönviita, (n. 14), para. 16.3.2.
[89] *Adria-Wien Pipeline,* (n. 64).
[90] Ibid, para. 36.
[91] Ibid, para. 49.
[92] Ibid, para. 52-53.

In the *Commission v Netherlands* Case, the selectivity requirement is considered.[93] This case did not involve a tax measure, but an emission trading scheme for nitrogen oxides. It is still relevant for cases regarding environmental tax measures, because the Court applies the same reasoning in both situations. The emission trading scheme includes a reduction standard for undertakings which emit small amounts of nitrogen oxides. The General Court had found that the distinction made between undertakings with small or large emissions was in accordance with the general scheme of the system and that this distinction was justified by ecological considerations, because undertakings with higher nitrogen oxide emissions are more polluting and the goal of the measure is the protection of the environment.[94] The Court of Justice disagrees and follows the opinion of AG Mengozzi instead. He states that nitrogen oxides emissions are harmful in any quantity, so the distinction is not justified by the objective of environmental protection, because it is not inherent to the emission trading scheme.[95] The measure is therefore selective and constitutes state aid.

The same reasoning on state aid and selectivity can be seen in the *Naturgy Energy Group v Commission* case. In this case, Spain has a financial aid scheme for environmental investments in coal-fired power stations. The commission initiated a formal investigation procedure regarding this aid scheme and reached the preliminary conclusion that it was state aid. Naturgy Energy Group started a procedure to annul this decision of the Commission. There is no evidence that coal-fired power plants have to make environmental investments that other power plants do not have. Power Plants that are coal- fueled and power plants that use another type of power are thus in a comparable factual and legal situation. The aid also did not have an environmental incentive effect, because it was granted for implementing mandatory EU standards. The measure would lead to no extra environmental benefits. The Commission was therefore right in determining the aid scheme as a selective advantage to coal-fired power plants.[96]

The *Axpo Trading* case concerns a green certificate scheme that had the objective of protecting the environment.[97] In his opinion, Advocate General Campos Sánchez-Bordona, has assessed the selectivity of this scheme. The selectivity depends on the statutory regime that is used for reference. The purpose of Directive 2009/28 is to favour the use of green energy in each member state. The Directive is therefore inherently selective so if the Directive is used as the statutory regime the scheme will most likely not be

[93] Judgement of 8 September 2011, *European Commission v Kingdom of the Netherlands*, C-279/08, EU:C:2011:551.
[94] Ibid, para. 76.
[95] Opinion of AG Mengozzi in Judgement of 8 September 2011, *European Commission v Kingdom of the Netherlands*, C-279/08, EU:C:2010:799, para. 54-55.
[96] Judgement of 4 March 2020, *European Union Intellectual Property Office v Equivalenza Manufactory, SL*, C-328/18, EU:C:2020:156.
[97] Opinion of Advocate General *Campos Sánchez-Bordona in Axpo Trading Ag v Gestore dei Servizi Energetici SpA – GSE*, C-705/19, EU:C:2020:989.

considered selective.[98] If, on the other hand, the national rules regarding electricity would apply as the statutory regime, the scheme would be considered a derogation, because the national rules are not inherently selective. Even in that case, the scheme might be justified because of its environmental protection objective, which is part of the general scheme of green certifications and the fact that it complies with Directive 2009/28. The decision on compatibility with the internal market can only be made by the Commission.[99]

5.2.3 Qualification as state aid

The *ANGED case* concerns the taxation of retail establishments in Spain. Certain Spanish regions imposed taxes on retail establishments to reflect the environmental damage caused by such establishments. The taxes only imposed on large retail establishments and there was an exemption for small retailers and for large retailers selling certain products which required large sales aereas. The ECJ stated that tax exemptions based on the size or nature of the activities of an establishment do not constitute state aid, provided that the establishments that are exempted from the tax have a smaller negative impact on the environment. In this case the two groups of large establishments were objectively in a comparable situation regarding their environmental impact. Therefore, the exemption in this case was selective and constituted state aid.[100]

The ANGED case was the first case where the environmental nature of the tax measure resulted in it not being qualified as state aid.[101]

5.2.4 Aid with negative effects on the environment

In the *Hinkley Point* case, the Commission approved the UK's plans to give state aid for the construction of a nuclear power plant.[102] The construction of a nuclear power plant is regulated by the Euratom Treaty, which has no provisions on state aid. Therefore, the Court stated that the state aid rules of the TFEU are applicable.[103] Article 107(3) TFEU states that: "aid may be considered compatible with the internal market aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest". The Court then states that based on Article 107 TFEU state aid which contravenes provisions or general principles of EU law cannot be declared compatible with the internal market. Then the Court states that state aid which contravenes rules of EU law on the environment cannot be declared compatible with the internal market.[104] This is contrary to the findings of the General Court in this case. However, later in this case, the Court states that the objective of EU policy on energy is to ensure the functioning of the energy market and to safeguard

[98] Ibid, para. 167-170.
[99] Ibid, para. 171-177.
[100] Judgement of 26 April 2018, *ANGED,* C-236/16, EU:C:2018:291.
[101] Pedroso & Kyrönviita, (n. 14), para. 16.3.2.
[102] Judgement of 22 September 2020, R*epublic of Austria v European Commission*, C-594/18, EU:C:2020:742.
[103] Ibid, para. 45.
[104] Ibid, para. 44-46.

energy supply.[105] The Commission does not need to include the negative effects on the environment in making its decision on state aid. The reason for this is that Member States are free to choose their energy sources and the conditions under which these sources are exploited. State aid cannot be prohibited because of negative environmental effects.[106]

5.3 Fundamental Freedoms

5.3.1 Justifications

In the *Frohnleiten case* the ECJ considers an Austrian tax on the dumping of waste.[107] Tax exemption is only available for the dumping of waste from Austrian sites. First, the Court decides that even if waste for disposal has no intrinsic commercial worth, it can nonetheless result in commercial transactions when it is disposed of or deposited. It can therefore be considered under Article 110 TFEU. A Tax system is only compatible with Article 110 TFEU if it is arranged to exclude any possibility of imported products being taxed more heavily than domestic products and, therefore, only if it cannot in any event have discriminatory effect.[108] In this case the tax was discriminatory. Consequently, the Court will consider the possible justifications. The relevant justification in this case regards the material impossibility.

The Austrian Government claimed that identifying disused hazardous sites or suspected contaminated sites in other Member States was impossible. The Court stated that practical difficulties cannot justify the application of internal taxation which discriminates against products from other Member States.[109] Justification based on material impossibility was therefore not possible and the Court concluded that the tax measure in question was incompatible with the internal market.

In the *Outokumpu Oy* case the Court was asked to rule on the compatibility of a tax imposed in Finland on electricity. This tax was designed as an excise duty imposed both on domestically and imported electricity. The tax rate for electricity produced in Finland was determined on how the electricity was produced, with a lower tax rate for environmentally friendly production. However, electricity from outside Finland was subject to a flat rate. This meant that the tax rate on imported electricity could be higher, but the Court stated that under article 110 TFEU member states are allowed to adopt different tax rates on environmental grounds. However, discrimination against imported products was not allowed.[110]

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[105] Ibid, para. 48.
[106] Ibid, para. 48-50.
[107] Judgement of 8 November 2007, *Stadtgemeinde Frohnleiten and Gemeindebetriebe Frohnleiten GmbH v Bundesminister für Land- und Forstwirtschaft, Umwelt und Wasserwirtschaft*, C-221/06, EU:C:2007:657.
[108] Ibid, para. 50.
[109] Ibid, para. 70.
[110] Outokumpu Oy, (n. 73) para. 31, 39-41.

The Court came to the same conclusion in the *Tatu* Case.[111] AG Sharpston stated in her opinion that environmental protection cannot take away the discriminatory nature of a tax measure.[112]

In the *Presidente del Consignli dei Ministri v. Regione Sardegna* case the compatibility of a tax on tourists on stopovers was discussed. This tax was considered a restriction on the freedom to provide services, because the tax was not imposed on operators who were located in the territory of Sardinia. This distinction between passengers from different operators was not based on environmental grounds. The Court stated that for a discriminatory tax to be justified the tax has to genuinely reflect an objective to attain its alleged environmental objectives in a consistent manner.[113]

5.3.2 Proportionality

In *European Commission v. Ireland* the Court decided on a tax imposed on rental vehicles that was dependent on the level of CO2 emissions. The aim of the measure was environmental protection, which would be achieved by imposing a higher tax on heavy emission vehicles to discourage the renting of vehicles with high fuel consumption. To be compatible with the internal market, a tax measure must be appropriate for attaining the tax measure's objective. The Court decided that this was the case and the discriminating nature of the tax was justified by the general objective of the system. However, there was also an administration charge, which was levied on top of the tax. The Court found the extra administration charge in combination with the high amount of tax to be disproportionate.[114]

5.3.3 The renewable energy cases

The *Ålands Vindkraft case*[115] concerns a Swedish green-certificate support scheme for electricity produced from renewable sources.The scheme had two parts: first, it awarded electricity certificates for each megawatt-hour of green electricity produced in Sweden, and second, it required suppliers and certain electricity users to give a certain amount of certificates to the authorities, which was equal to a percentage of the total amount of electricity supplied or consumed the previous year. The certificate scheme provided an economic advantage for energy producers. However, it was only accessible to producers located in Sweden. Ålands Vindkraft exported green electricity to Sweden and could therefore not benefit from the green certificates scheme.[116]

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[111] Judgement of 7 April 2011, *Ioan Tatu v Statul român prin Ministerul Finanţelor şi Economiei and Others*, C-402/09, EU:C:2011:219.
[112] Opinion AG Sharpston in Judgment of 7 April 2011, Ioan Tatu v Statul român prin Ministerul Finanţelor şi Economiei and Others, C-402/09, EU:C:2011:32*, para. 38.*
[113] *Presidente del Consiglio dei Ministri v Regione Sardegna*, (n. 82), para. 42.
[114] Judgement of 19 September 2017, *European Commission v Ireland*, C-552/15 EU:C:2017:698, para. 43.
[115] Judgement of 1 July 2014, *Ålands vindkraft AB v Energimyndigheten*, C-573/12, EU:C:2014:2037.
[116] Ibid.

The Court was asked to decide on the question of whether this scheme constitutes a measure having equivalent effect to quantitative restrictions, and is therefore a restriction to the freedom of goods, and whether the environmental objective of the measure could justify the restriction.

In a similar case, *Essent Belgium*, the Court also decided on a green-certificate support scheme. This scheme required Belgian energy producers to provide a number of certificates to the regional authority, corresponding to a proportion of the total volume of electricity they supplied in that region. The certificates were provided to producers of renewable energy, which could then trade them. The producers could only receive the certificates from domestic producers. Essent did not fulfil its quota of green-certificates and argued that this would have been possible if green electricity which originated from other Member States could be used for the requirement.[117]

Advocate General Bot argued that both schemes were incompatible with EU law in his opinion[118]. The Court went against this and ruled that the schemes were compatible with EU law. Although the schemes did constitute restrictions to the free movement of goods, the restriction was justified by its environmental protection objective.

5.4 Secondary Law

5.4.1 The general arrangement directive case law

The general arrangement directive contains provisions on indirect taxation. It regulates the adoption of indirect taxes on products that fall within its scope. In order to adopt environmental tax measures compatible with this directive the measure needs to pursue a "specific purpose". In order to be regarded as pursuing a specific purpose it is not enough to prove that the tax was aimed at an objective "other than purely budgetary objective", instead a tax must be directed at protecting health and the environment.[119]

In the *Statoil case* Estonia adopted legislation which allowed local authorities to adopt a sales tax.[120] The city of Tallinn then implemented such a tax, which was levied, among other things, on the retail sale of liquid fuel. The objective of the tax was stated as promoting the use of public transport in order to reduce the harmful effects and damage to health caused by cars.[121] The relevant EU legislation in this case is Article 1(2) of Directive 2008/118, which states that: "Member States may levy other indirect taxes on excise goods for specific purposes, provided that those taxes comply with the Community tax rules applicable for excise duty or value added tax

[117] Judgement of 29 September 2016, *Essent Belgium NV v Vlaams Gewest and Others*, C-492/14, EU:C:2016:732.
[118] Opinion of AG Bot in Judgement of 29 September 2016, *Essent Belgium NV v Vlaams Gewest and Others*, C-492/14, EU:C:2016:257.
[119] *Transportes Jordi Besora*, (n. 52), paras 23, 29, 30.
[120] Judgement of 5 March 2015, *Tallinna Ettevõtlusamet v Statoil Fuel & Retail Eesti AS,* C-553/13, EU:C:2015:149.
[121] Ibid, para. 6-19.

('VAT') as far as determination of the tax base, calculation of the tax, chargeability and monitoring of the tax are concerned, but not including the provisions on exemptions."[122]

Statoil, a company operating in the resale of liquid fuel, was ordered to pay a sales tax on the retail sale of liquid fuel in 2010 and 2011. Liquid fuel was also subject to excise duty, on top of this sales tax. There was no exemption or deduction possibility for the sales tax, when there was already an excise duty levied on the same goods. Statoil claimed this was a violation of EU Law, specifically Article 1(2) of Directive 2008/118 (GAD II).[123]

The Court first stated that the GAD II is applicable in this case. However, the relevant provision, Article 1(2) of GAD II has not changed significantly since the previous directive,[124] which means that the case law pertaining to this provision in the GAD I is still applicable to cases relating to Article 1(2) of the GAD II.[125]

Indirect taxes levied on goods which are subject to excise duties under the GAD are only compatible with the GAD II (and thus EU law), if they comply with two cumulative requirements laid out in Article 1(2). First, they need to be levied for one or more specific purposes. The second requirement is that they are compliant with EU tax rules applicable to excise duty and VAT. The objective of these requirements is to prohibit additional indirect taxes that would obstruct trade.[126]

From previous case law it follows that a specific purpose is a purpose other than a purely budgetary purpose. However, this does not mean that any tax with a (mainly) budgetary purpose is excluded. As long as there is also another purpose present, a tax will be considered as having a specific purpose. [127]

There also needs to be a direct link between the tax and the specific purpose. In other words, the revenue from the tax must be used directly to achieve this purpose. If this is not the case, a tax could still be considered as having a specific purpose, but only if the tax is structured in a way that will change the taxpayers' behaviour in order to achieve this purpose. For example, a tax could be levied on goods that are harmful to the environment to discourage taxpayers from purchasing them.[128]

The revenue from tax on liquid fuel was used for organising public transport in Tallinn. Even though an environmental purpose was stated for the tax, there was no direct link between the collected revenue and the environmental purpose. The revenue was not specifically allocated for any specific purpose. The organisation of public transport cannot be considered a specific purpose, because this is just general expenditure and it could also

[122] Ibid.
[123] Ibid, para. 20-23.
[124] Article 3(2) of Directive 92/12/EEC.
[125] *Statoil* (n.120), para. 34.
[126] Ibid, para. 35-36.
[127] Ibid, para. 37-40.
[128] Ibid, para. 41-42.

be financed through other revenue. Because the tax at issue has no specific purpose, it is incompatible with EU law, specifically Article 1(2) GAD II.[129]

In the *Messer France case* the ECJ elaborates on the requirements for the adoption of environmental tax measures under the general arrangements directive. This case concerns tax on electricity in France which was directed at achieving an environmental objective because it encouraged the production of electricity from renewable sources. In this case the revenue collected by the tax measure was partially allocated to the promotion of green electricity. However, part of the revenue was dedicated for administrative and social purposes. The court decided that allocation of revenue from an indirect tax is not sufficient to prove that the tax is directed at a specific purpose. However, the part of the tax revenue which was allocated for the other objectives could not be considered an indirect tax under the general arrangement directive.[130]

5.4.2 Energy Taxation Directive case law

The *Braathens case* is an example of a tax measure with a genuine environmental objective which was still considered incompatible with the Energy Taxation Directive (ETD).

The case concerns a Swedish tax on aviation which was exempt under the previous ETD. The tax could not be allowed under the GAD, because it was exempted in the ETD and if member states could adopt tax measures on products that were covered by the exemption the exemption would be useless.

The environmental nature of the tax did not change the court's decision.[131] The ETD has been revised since then and it would be unlikely that this situation would happen with the current ETD, because the exemption no longer exists.

5.4.3 Renewable Energy Directive case law

In the *Oliva Park case* the Court considered a Spanish Energy Tax under the renewable energy directive. The energy tax is imposed on all domestic energy sources, with the purpose of revenue collection. The Court states that it is not incompatible with the Directive, to impose a tax on renewable energy, even if the measure is possibly detrimental for environmental protection and the only purpose is revenue collection.[132]

5.5 Conclusion

From this case law it is clear that the structure of a tax measure does not matter for it being defined as an environmental tax measure or not. What

[129] Ibid, para. 43-48.
[130] Judgement of 25 July 2018, *Messer France SAS v Premier ministre and Others,* C-553/13, EU:C:2018:587.
[131] Judgement of 10 June 1999, *Braathens Sverige AB v Riksskatteverket,* C-346/97, EU:C:1999:291.
[132] Judgement of 3 March 2021, *Promociones Oliva Park SL v Tribunal Económico Administrativo Regional (TEAR) de la Comunidad Valenciana*, C-220/19, EU:C:2021:163, paras. 70, 77-78.

matters is that there is a genuine environmental objective. However, that is not always enough. In some cases, especially when the measure is regulated by harmonised tax law, even measures which are genuinely aimed at environmental protection are not compatible. The Court has balanced environmental and economic objectives in each case. This is done from an economic perspective. Environmental tax measures are first considered as barriers to free trade or distortions of competition, which could then be justified by environmental objectives. In a balanced sustainable development model environmental sustainability should be taken into consideration in the qualification of tax measures as well so that a genuine environmental tax measure would not be qualified as a restriction of the fundamental freedoms or a distortion of competition in the first place. This perspective of always assuming economic objectives in the first place is not in line with sustainable development. In cases where measures are possibly harmful for the environment the court does not take environmental objectives into account at all. If economic and environmental sustainability were truly in balance, it would not be possible to decide that a measure is compatible with the internal market while only economic objectives were considered.

6 Conclusion

There has always been a resistance against tax harmonisation in the EU, because member states do not want to lose their tax sovereignty. This has resulted in uncoordinated tax policies. Member states are only limited by the prohibition against state aid and restrictions to the fundamental freedoms, with the exception of the few tax areas that are harmonised (VAT and energy taxation).

In recent years the EU has adopted new policies and legislation for reaching the goals set by the Paris Agreement on climate change. Environmental tax measures are an important part of the new policy package and are essential for reaching the targets.

The EU's environmental policy is currently sufficient for achieving the climate goals of the Paris Agreement. However, not all member states have fully implemented the policies yet, which means that currently the EU is falling behind on reaching the target of reducing emissions by 55% by 2030.[133] The lack of harmonisation is an important reason for why environmental tax measures are not always effective in the EU.

The new policy does leave more room for member states to adopt their own environmental tax measures. It is unlikely that genuine environmental tax measures would be considered incompatible with EU law, such as happened in the past.[134] Member states have more room to adopt environmental tax measures that go beyond the EU policies, however, on the other hand, member states who do not implement those policies are free to do so as well. Even tax measures which would lead to negative environmental effects cannot be declared incompatible with the internal market.[135]

Sustainable development is defined as a balance between social, economic, and environmental sustainability. This concept is incorporated in EU law in many places, most importantly in article 11 TFEU, which means that all EU laws should be interpreted by taking both economic and environmental objectives into account, with neither being more important than the other. In reality this does not seem to be the case.

Environmental tax measures, even if they are genuine, are often limited by internal market objectives, while at the same time tax measures favouring polluting products cannot be limited by environmental objectives.

Economic sustainability has always been a more important principle in EU tax policy. This can clearly be seen in the current energy crisis. The EU was on its way to achieving climate goals when the energy crisis started. It is now allowing member states to subsidise energy products from fossil fuels energy production from polluting sources, such as coal. The EU has already created new energy supplies from non-renewable sources. This has undone some of the progress that had finally been made in environmental

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[133] "Policies & Action" (*Policies & action | Climate Action Tracker*) <https://climateactiontracker.org/countries/eu/policies-action/> accessed June 22, 2022.
[134] See paragraph 5.4.2.1.
[135] See paragraph 5.2.4.1

sustainability in the energy sector and it shows that even with the increasing climate crisis environmental sustainability is still not at the same level of importance as economic sustainability.

Environmental tax measures have the potential to be great tools for achieving policy goals, mainly due to their regulatory function. However, this is not fully true for the EU. Although environmental tax measures definitely have improved the progress towards sustainable development goals, they could be much more effective by increasing harmonisation and by giving environmental sustainability a more prominent place.

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