Energy Taxation Directive

Bellona Europa welcomes the proposed revision of the Energy Tax Directive primarily because the weight of environmental factors in defining the level of taxation has increased. Moreover, the strive to foster the use of renewable electricity across the directive is a very positive development. Likewise, some necessary steps forward, such as the end of tax exemptions for fossil fuels for waterborne navigation and aviation (excluding cargo-only flights) are very welcomed by Bellona Europa.

Nevertheless, the push for alternative fuels as part of the overall objective of the proposal, given the current uncertainty around the RED II delegated act for electricity use for RFNBO production, is something whose impacts are hard to assess.

Finally, some shortcomings remain in the draft. Most importantly, the exclusion of cargo-only flights, the adoption of weak biomass sustainability criteria from RED II and the persisting tax exemption for unabated fossil gas used in combined heat and power plants are missed opportunities. Bellona Europa believes that these issues should be mitigated in the upcoming legislative negotiations. Below we delve into details on the ability of this directive to address some of the key issues.

RFNBO/Hydrogen production

As previously highlighted by Bellona Europa, as efforts to decarbonise our economy and energy systems pick up, we are seeing an increased risk for future reliance on so-called ‘decarbonised’ fuels, gas in particular – oftentimes referred to as “renewable” and “low-carbon” gases. While actual low carbon intensity gases and fuels can contribute to the path to net-zero by 2050, the terminology is confusing, with no standard legal definition to determine when gas or fuel is renewable or low-carbon.

Although still incomplete, the directive released provides a suggested definition of a “low-carbon fuel”. This is an important step in the right direction, but based on the proposed definition in the ETD it is still unclear what exactly the definition would entail. Bellona Europa has already proposed guidelines to follow when setting such a definition. More information about the principles to follow when developing a sound definition can be found in our briefing.

Taxation on RFNBOs will remain lower than taxation on fossil fuels, creating a market context that fosters their development. This could potentially have a negative impact depending on the delegated act for electricity use for RFNBO production. As highlighted in our recently released briefing, the failure to ensure additionality for the production of RFNBOs would lead to a cannibalisation of the renewable energy generation for the hydrogen production, putting at risk the overall energy transition. In parallel, there is a risk of double-counting emission reductions from CO2 use, which must be addressed by building on the current wording of the ETS proposal: that the use of CO2 counts as an emission unless it is permanently chemically bound and shall not enter the atmosphere under normal use and disposal. Given this risk, one should cautiously assess the potential increase of RFNBOs uptake driven by favourable taxation.

Finally, the extended tax exemption for RFNBOs used in aviation, followed by a very slow phase-in of taxes through a transitional phase only ending in 2043, will drive up the consumption of hydrogen in the aviation sector. The lack of a clear definition of what will fall within the RFNBOs category concurs in creating a higher level of uncertainty on this point.
The use of synthetic fuel and biofuels in the sector will divert significant resources away from other applications, such as low carbon technologies for decarbonisation of primary industries, without providing the necessary safeguard to ensure emissions are actually reduced in the process.

**Unabated fossil fuels**

Some of the tax exemptions on fossil gas have been removed in the current draft, though exemptions for combined heat and power (CHP) plants remain. Tax exemptions should be warranted only to abated gas (i.e. emissions captured and stored permanently) in CHP. In contrast, unabated gas should be fully taxed regardless of application at its full climate impact throughout the value chain.

Most importantly, it phases out the exemptions for fuels used in the aviation and maritime sectors, moving towards a fairer taxation regime. However, cargo-only flights remain exempted. We identify this as a significant issue as it strongly impacts the development of a circular economy and a broader shift towards cleaner modes of freight transport. Cheap air cargo is a prerequisite for short product life cycles. This is most noticeable in electronics, where unsustainable products are enabled by cheap fast transport. Exemptions should be warranted only for indispensable goods such as medical supplies in cases of emergencies or crises. On the contrary, any regular operation should be heavily taxed to disincentivise the uptake of unsustainable practices.

**Biomass**

A clear differentiation throughout the directive has been applied regarding the taxation of biomass according to its supposed sustainability, relying on definitions from the RED. This differentiation is a positive development; however, a ten-year grace period has been afforded to the use of unsustainable biomass, which is unacceptable given the sheer scale of biomass use in the plan for up to 2030, not to mention that this will mean biomass will only be treated on par with the use of fossil fuels by 2033 (from the perspective of their emissions output).

The tax exemptions for producing electricity from sustainable biomass are a slight improvement; however, we ask that no tax exemption apply for the combustion of biomass for electricity production. In the proposal, biomass is assumed to have low or zero-carbon content, which is inherently false and would incentivise the combustion of biomass at the expense of other uses of biomass that retain the carbon content and any measures that could prevent it from reaching the atmosphere.

**Climate infrastructure funding**

Although this directive does not allocate funding directly, allowing Member States to reduce the tax rate applied to some solutions will mobilise finance towards them. In particular, tax exemption will be allowed for electricity supplied to berthed ships, incentivising onshore power supply. This would create a very positive synergy with the obligation for berthed ships to use onshore energy proposed within the FuelEU Maritime regulation.

Moreover, electricity and fuels used for local public transport and rail are also eligible for tax exemptions, incentivising the collective mobility over the private one. This is an important step forward. However, a clear phase-out of fossil fuels must be envisaged in this sector as well. Thus a different treatment between renewable and fossil energy sources should be reflected in the tax system.