EXPLANATORY MEMORANDUM FOR EUROPEAN UNION LEGISLATION WITHIN THE SCOPE OF THE UK/EU WITHDRAWAL AGREEMENT AND NORTHERN IRELAND PROTOCOL

10872/21

COM (2021) 563 Final

Proposal for a COUNCIL DIRECTIVE restructuring the union framework for the taxation of energy products and electricity

Submitted by HM Treasury August 2021

SUBJECT MATTER

1. The Energy Tax Directive (ETD 2003/96/EC) governs the taxation of energy products and electricity and aims to ensure the proper functioning of the EU internal market, setting minimum tax rates for these products.
2. The EU's supporting documentation for the draft directive notes that the current ETD requires reform given it has been in place since 2003 and no longer aligns with current EU polices on climate change. In particular, it does not adequately promote greenhouse gas emissions reductions, energy efficiency and the take-up of electricity and alternative fuels (renewable hydrogen, synthetic fuels, advanced biofuels, etc.) because these new, less carbon-intensive fuels are taxed as their fossil equivalent if they have emerged since the 2003 and therefore have no explicit rate. There are also a wide range of exemptions from the minimum rates which means the ETD incentivises fossil fuel use as fossil fuels are typically more energy dense. Finally, the supporting documentation notes that some aspects of the current ETD are unclear and this created uncertainty and difficulties in its implementation.
3. The draft directive therefore proposes moving from taxing energy products by volume, and instead taxing based on energy content and environmental performance. This aims to ensure fossil fuels, which are more energy dense, are taxed more heavily than alternative fuels or electricity.
4. The draft directive also proposes including more products in scope and removing some of the current exemptions and reductions. For example, the regulation proposes that kerosene used as fuel in the aviation industry and heavy oil used in the maritime industry will no longer be fully exempt from energy taxation for intra-EU voyages.
5. The proposed reforms are part of the EU's Fit for 55 package, which seeks to implement the EU's new greenhouse gas emissions reduction objectives.

SCRUTINY HISTORY

6. The most recent Government EM on this issue was provided on 10 June 2011 (Proposal for a Council Directive amending Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity). The Commons European Scrutiny Committee reported that the proposal raised sufficient issues of importance to warrant substantive reports to the House on 5 occasions and completed scrutiny of the proposal on 9 September 2015 following an update from Minister Hind on 13 July 2015 that the Commission had withdrawn the proposal. The proposal was examined the by the then European Union Committee's sub-committee A, who completed their scrutiny following notification that the proposal had been withdrawn.

MINISTERIAL RESPONSIBILITY

7. The Chancellor of the Exchequer has responsibility for United Kingdom policy on European Union monetary and economic issues.

INTEREST OF THE DEVOLVED ADMINISTRATIONS

8. The taxation of energy products and electricity is a reserved matter. However, given the possible relevance of the Northern Ireland Protocol, the Northern Ireland Executive has been consulted in the preparation of this EM. The Scottish and Welsh Governments have not been consulted.

LEGAL AND PROCEDURAL ISSUES

i. Legal Base

9. The proposal is based on Article 113 of the Treaty on the Functioning of the European Union (TFEU), which permits the EU to lay down harmonised rules relating to indirect taxation in order to ensure the proper functioning of the internal market. Additionally, appropriate provisions of fiscal nature intended, inter alia, to preserve and protect the environment can be adopted according to Article 192(2), first paragraph, of the TFEU.

ii. Voting Procedure

10. Unanimity of the Council of the European Union following consultation with the European Parliament and the Economic and Social Committee.

iii. Timetable for adoption and implementation

11. As currently drafted, the draft directive requires domestic legislation implementing the changes to be adopted by 31 December 2022. The changes

to the minimum rates of taxation for energy products are to be phased in over a period of 10 years from 2023 to 2033. During the transition period the minimum rates will be 1/2 to 2/3 of the reference rate.

POLICY IMPLICATIONS

12. The current Energy Tax Directive (Council Directive 2003/96) applies to and in Northern Ireland by virtue of Article 8 of the agreement under the Northern Ireland Protocol, and is listed in Part 2 of Annex 3. We will therefore continue to monitor the EU proposals as they develop, to determine whether some or all parts of the revised ETD also fall within scope of the agreement. More broadly, the Government is seeking to find a new balance in operating the Protocol in order to place it on a more sustainable footing. The Government's July 2021 Command Paper (Northern Ireland Protocol: the way forward), set out these re-balancing proposals, which include arrangements covering trade in goods and the institutional framework. These proposals seek to remove potential UK internal market consequences, while ensuring there are no significant market distortions on the island of Ireland.

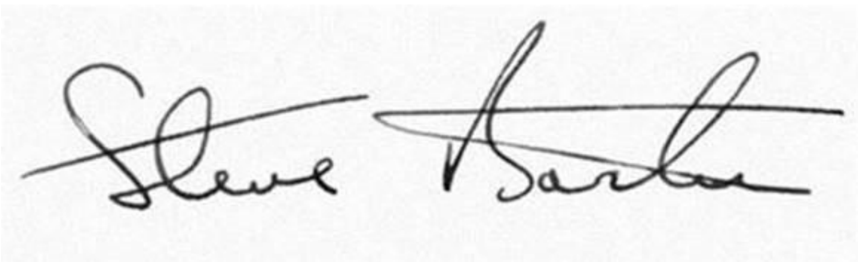
CONSULTATION

13. No consultation has been carried out.

FINANCIAL IMPLICATIONS

14. No financial implications have been identified at this stage.

15. **MINISTERIAL NAME AND SIGNATURE**



Rt Hon Stephen Barclay MP

Chief Secretary to the Treasury

HM Treasury