

THE CHALLENGES OF ENVIRONMENTAL TAXATION IN THE ENERGY CRISIS

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When speaking about environmental taxation, it should be pointed out from the outset that, strictly speaking, it does not follow one single definition. To simplify, two main definitions can be mentioned. The first consists in the *statistical* or ‘material’ definition, according to which “an ‘environmentally related tax’ means a tax whose tax base is a physical unit (or a proxy of a physical unit) of something that has a proven, specific negative impact on the environment”¹. This means that to be considered as an environmental tax, according to the OECD and EU definition, a tax must have as its tax basis a certain quantity of some product or activity. Those are usually measured by using units or weight. For instance, a carbon tax can be based on a price set per tons of carbon dioxide emitted by a given activity.

The second definition is called the *purposive* approach because it focuses on what the tax actually sets out to do. In other words, according to this definition, the tax has to be a genuine part of an environmental policy. Looking at the purpose of a tax allows us to better categorise this branch of tax law, as its unifying principle is that the rules were made with the goal of environmental protection. However, as it is not based on strictly defined legal conditions, it allows for a larger degree of interpretation and its boundaries are not always clear.

Professor Robert Herzog, a leading proponent of the purposive approach, mentions four criteria to help identify environmental taxes². First, its tax basis

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¹ Regulation (EU) No 691/2011 of the European Parliament and of the Council of 6 July 2011 on European environmental economic accounts, available at: <https://tinyurl.com/3ws9t6u>

² Robert HERTZOG: Le droit fiscal de l’environnement : en croissance sur des fondements incertains. *Revue Française de Finances Publiques*, n° 114. (2011) 149.

consists in a pollution or some kind of harm to the environment (this is much like the statistical approach seen above). Second is the tax rate, which can be modulated according to the severity of the pollution. The third is the tax revenue: it can be allocated to environmental policies. Fourth and last is the case of tax spending: either reducing or removing altogether a tax on greener alternatives to polluting products or activities.

1. Environmental taxation's lack of evolution in the last decade

The idea of environmental taxation can seem rather obvious in hindsight. After all, states often resort to fiscal policies in order to address issues, especially when a more hands-on approach – as in, enforcing or banning certain products or activities by law – would appear to meddle too heavily in economic activity. At the same time, taxation offers the benefit of gaining revenue for the Treasury, which is not the case for self-regulation of economic actors. The latter experienced varying degrees of success: when compliance can be achieved with minimal efforts from the relevant industry, self-reliance can be effective. For instance, the Global Gas Flaring Reduction Partnership (GGFRP) is not without merit, as it allows to reduce the practice of releasing wasteful emissions in the atmosphere³. On the other hand, the rise of so-called “carbon-offsets” schemes, purporting to compensate carbon emissions by investing in green projects, has been denounced as a mere marketing ploy, also known as greenwashing, or at the very least their efficiency has been seriously called into question⁴.

Resorting to fiscal policies can appear as a middle ground between direct legislative intervention and simply encouraging industries to behave responsibly. One of the main theoretic foundations of environmental taxation is the ‘polluter pays’ principle, which posits that the cost of preventing and reducing pollution should fall on those who have caused said pollution. Officially adopted by

³ See the World Bank’s webpage on this issue, available at: <https://www.worldbank.org/en/programs/gasflaringreduction>

⁴ For a thorough assessment of carbon offsets schemes, see: R. CALEL – J. COLMER – A. DECHEZLEPRÊTRE – M. GLACHANT: Do carbon offsets offset carbon? *Centre for Climate Change Economics and Policy Working Paper 398/Grantham Research Institute on Climate Change and the Environment Working Paper 371.*, November 2021. available at: <https://tinyurl.com/mtkb6bdt>

international organisations such as the OECD in 1972⁵, later by the EU⁶, the ‘polluter pays’ principle is present in the French legal system at the legal level⁷ but also in a text of constitutional value, the Environmental Charter (*Charte de l’environnement*), adopted in 2004⁸. It therefore remains of core importance in justifying environmental taxation. Despite being ubiquitous nowadays, the ‘polluter pays’ principle had long been a subject of debate on each side of the spectrum, as Ministries were wary of the loss of economic competitiveness environmental taxes might provoke, while environmental activists argued these taxes would effectively allow large companies to simply purchase a “right to pollute” instead of changing their behaviour.

The double dividend theory, formulated in the 1990s, gave new impetus to attempts to implement environmental taxation.⁹ The crux of the argument was that environmental taxes would not only help reduce pollution, but would also benefit the economy, as the revenue raised from new environmental taxes would allow states to reduce other taxes and thus stimulate growth. Expecting to cumulate the environmental dividend and the economic dividend, policymakers soon set to work. However, in practice, environmental taxes have suffered setback after setback. In 2000 and 2009, plans for a tax on energy products failed after being deemed unconstitutional by the Constitutional Council¹⁰. In 2013, a tax on heavy goods vehicles (designed to penalise road freight in favour of waterway and rail transport) was scrapped following a virulent protest movement centred in Brittany, the so-called “red caps” (*bonnets rouges*), which saw the tax as detrimental to the region’s economic interests. In 2018, the Yellow Vests movement rose in reaction to the planned increase in the rate of carbon tax on fuels, although the protests soon took on a more social character, seriously shaking the government’s authority.

⁵ OCDE, *Recommandation du Conseil sur les principes directeurs relatifs aux aspects économiques des politiques de l’environnement sur le plan international*, Document N°C(72)128, Paris, 1972.

⁶ Article 191 (2) TFUE, available at: <https://tinyurl.com/yp6vbkkn>

⁷ Code de l’environnement, art. L110-1 II. 3°, available at: <https://tinyurl.com/4smpxsec>

⁸ Charte de l’environnement, article 4, available at: <https://tinyurl.com/bdd37htf>

⁹ Aurélien Baudu, ‘La fiscalité environnementale française : une fiscalité de rendement ou d’incitation ?’ (2012), *Revue française d’administration publique* n° 144, 981–993.

¹⁰ Conseil constitutionnel, Décision n° 2000-441 DC du 28 décembre 2000, *Loi de finances rectificative pour 2000*, <https://tinyurl.com/yh56m2e8> ; Conseil constitutionnel, Décision n° 2009-599 DC du 29 décembre 2009, *Loi de finances pour 2010*, <https://tinyurl.com/4h3z7hby>

2. Conflicting priorities: budgetary vs. environmental concerns

Repeated failures of environmental taxation are no accident. Indeed, it can be argued that they occur because of some intrinsic difficulty in integrating environmental goals in the realm of taxation, which follows quite different rules and is not as easy to reform as one may think. In France, the Constitutional Council is the authority responsible for judging if a Budget Bill (where taxes are introduced) is compatible with the Constitution. The main justification for taxation is found in article 13 of the 1789 Declaration of Human Rights.¹¹ This provision not only states that a general tax is indispensable, it also affirms the necessity of taxation being equally distributed among all citizens, making equality in taxation a foundational principle of taxation in France. As a constitutional principle, it is known as equality in relation to public burdens (meaning mainly, but not exclusively, taxes). In practice, when judging the compatibility of a tax with the Constitution, particular attention will be paid to the adequation of the tax to the taxpayers' ability to pay (their financial means). Although many taxes do not really take into account the taxpayer's fiscal capacity (examples include expenditure taxes such as VAT or sales tax), this principle of tax equity remains a crucial element of constitutional doctrine as well as a social imperative, which is of paramount importance in order to ensure tax legitimacy and consent to taxation.

Environmental taxation, on the other hand, follows a completely different logic, since the primary objective is not a tax yield but a positive impact on the environment. In this sense, from the point of view of their environmental impact, there is no intrinsic difference between, for example, fuel for industrial use and the fuel used by rural dwellers who have no other choice but to drive. Similarly, oil heating is widespread in older dwellings as well as in dwellings not connected to gas. The demographic group most affected by an increase in oil taxes is generally not in a position to replace it regularly with greener energy sources. Environmental taxation is therefore more readily accepted when it is included in the price of a good or service, with a moderate rate. The idea of an 'invisible' environmental tax obviously runs counter to its objective of orienting the behaviour of economic operators: if households or businesses do not feel the weight of this additional taxation, there is no incentive to give up polluting

¹¹ Declaration Of Human And Civic Rights Of 26 August 1789, available at: <https://tinyurl.com/bdhjhz2t>

energy sources. In France, the best example of this puzzle is provided by the so-called carbon tax, or more technically the carbon component of energy taxes (oil and gas). The tax was introduced in 2014 and was supposed to increase gradually each year; in fact, it remained essentially painless because it was offset by falling global energy prices, but a rise in these prices in 2018 provoked a general uprising against the planned increase in the said tax. The Yellow Vests movement, which quickly took on a radical character, with demands far broader than simply cancelling the initial tax increase, proved that there is a limit to what a population is willing to accept in the name of protecting the environment. Indeed, when taxpayers perceive that their immediate economic security is threatened, environmental concerns take a back seat. In this case, the tax increase was particularly unwelcome because of the almost simultaneous abolition of the wealth tax (ISF) in the same year.

While article 13 of the 1789 Declaration could be interpreted as justifying taxation on solely budgetary purposes, the Constitutional Council does not follow such a restrictive view. However, it demands from the legislator that the means of an environmental tax are proportional and coherent with its stated objectives. In 2000 and 2009, careful reading of the proposed taxes revealed that they lacked coherence and could amount to taxing more heavily businesses that polluted less. As often, it turns out that taxation is not as adequate a tool as policymakers might have dreamt. In every situation when a new tax is created, the legislator has to weigh the interests of the taxpayers to avoid harming businesses' competitiveness or imposing a harsh burden on sectors of the population with no means to pay. This is not only a condition for compatibility with the Constitution, but also a necessity to guarantee social peace. Often, compromises will deviate a tax from its original goal: in 2012, a tax on sodas was introduced, citing health concerns – but the final draft also included so-called sugar-free drinks. The Council did not find the law contrary to the Constitution, modestly noting that the profitability objective had prevailed over public health concerns¹². When environmental objectives are introduced into the mix, the situation becomes even more confused. If the final draft of a law is not consistent with environmental objectives, its provisions risk being rejected by the Constitutional Council. This explains the relative cautiousness of governments and parliaments nowadays when it comes to introducing environmental taxes.

¹² Conseil constitutionnel, Décision n° 2011-644 DC du 28 décembre 2011, *Loi de finances pour 2012* <https://www.conseil-constitutionnel.fr/decision/2011/2011644DC.htm>

In view of the above, the question arises as to whether there are still any prospects for developing environmental taxation.

3. Targeting high-income taxpayers in a globalized economy: easier said than done

Recent developments in energy prices have highlighted the need to reduce dependence on fossil fuels through a combination of reducing overall energy consumption and finding alternative and sustainable energy sources. As the circumstances surrounding the present conference have proved, the prospect of energy scarcity is obviously a very serious challenge for Western states, but the current situation could also provide the impetus to overcome the usual obstacles; with options considerably reduced, the way forward could become clearer. In order to know in which direction environmental taxation can progress, it is necessary to know beforehand which taxpayers already bear the heaviest burden and which have the capacity to bear additional taxes. The idea of taxing large companies, particularly those with high profits, has resurfaced in the current crisis, in the form of taxes on exceptionally high profits, known in English as windfall taxes. They imply that profits are very high compared to previous years and that this rise is due to external circumstances and are not the industries' doing. Attempts at the national level have been varied, and we will merely point out the common issues at stake.

A windfall tax can be implemented in different ways. Of course, the simplest solution would be to increase the tax rate applied to exceptionally high profits. Because of the temporary and exceptional nature of the profits recorded, the tax would be levied on an ad hoc basis, separate from the regular taxation of profits – taking into account the profits made in recent years as a basis for determining the existence of an exceptional profit. It would also be limited in time. The main weakness of such a plan is that international energy companies already use tax schemes that locate profits in developing countries (where natural resource extraction usually takes place) and losses in developed countries. As a result, companies such as Shell in the UK or TotalEnergies in France pay virtually no tax. To counter this tax avoidance by multinationals, states have explored the idea of targeting a broader tax base than profits. For example, Italy has chosen value added, while Spain has targeted the turnover of certain companies. This method results in taxes that are more like excise duties than taxes on profits. It therefore suffers from the same shortcomings as most excise taxes, namely

the passing on of the cost of the tax to the price of the products. Therefore, such measures would have to be combined with some measure of price capping, which is very impractical and can only be legally introduced at the European level, where energy markets already follow a rather complex set of rules, which it is impossible to dwell on here.

Since the challenges posed by climate change as well as the energy crisis are global in their nature, international initiatives could prove more effective in tackling both issues. As regards the EU plans to curb carbon emissions, the Council and the European Parliament reached an agreement on the implementation of Carbon Border Adjustment Mechanism (CBAM), the objective being to set an adequate price to carbon emitted by the production of certain goods when imported into the EU. The mechanism aims at preventing what is called carbon leakage, that is, EU businesses resorting to imports from non-EU countries in order to circumvent environmental regulation applied inside EU borders¹³.

Regarding environmental tax issues more specifically, EU energy ministers agreed in September 2022 on the principle of a solidarity contribution, with the goal of collecting and redistributing the surplus revenue generated by the energy industry to final customers¹⁴. Working for all intents and purposes as a windfall tax, the contribution's modalities were laid out in an EU Regulation published in October 2022¹⁵. The tax's scope is quite limited, as it only included activities in the crude petroleum, natural gas, coal and refinery sectors and would assess the existence of exceptional profits by taking into account the average taxable profits of the past four years. Moreover, only profits exceeding a 20% increase compared to the referenced average would integrate the contribution's tax basis. With such a small basis, even the relatively high tax rate applied (minimum 33%) is unlikely to yield more than a symbolic revenue for Member States, especially compared to the energy costs incurred by final customers, which the solidarity contribution is supposed to support. At most, it might act as a deterrent for energy companies, so as to discourage any further price hikes.

Companies in the energy sector did not take kindly to this initiative. In December 2022, ExxonMobil engaged legal action against the EU Council and

¹³ See the European Commission's page on the topic: <https://tinyurl.com/556a9vj7>

¹⁴ See the press release of the EU Council: <https://tinyurl.com/4c657b3f>

¹⁵ Council Regulation (EU) 2022/1854 of 6 October 2022 on an emergency intervention to address high energy prices, art. 14 et seq. available at: <https://tinyurl.com/22vjvcdc>

challenged the legality of the aforementioned EU Regulation.¹⁶ It is doubtless too early to speculate on the future of these legal proceedings. Nevertheless, it is worth pointing out that, this time around, opposition to the new environmental tax did not emerge from social unrest or from internal legal controls, but from the fossil fuel industry itself. With cautious optimism, it may be a sign that this new environmental tax has finally hit the mark.

¹⁶ General Court of the European Union, Case T-802/22: Action brought on 28 December 2022 – ExxonMobil Producing Netherlands and Mobil Erdgas-Erdöl v Council, available at <https://tinyurl.com/33jwkmyx>