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Austria‘s ecological tax reform: a model for other EU Member States?

Robin Damberger (Ministry of Finance of the Republic of Austria) · Thursday, February 3rd, 2022

A new carbon pricing instrument

In autumn 2021, the Austrian government presented its long announced **eco-social tax reform** as part of its climate strategy to minimize the Austrian greenhouse gas emissions to net zero by 2040. The Austrian Ecological Tax Reform Act contains a variety of climate and compensatory measures for citizens and companies. A central part of the tax reform is the implementation of a new explicit carbon pricing instrument, the national emission trading scheme (Nationales Emissionszertifikatehandelsgesetz – NEHG) applicable as of July 2022. The NEHG does not replace the existing energy taxes in Austria but complements them. The following blog post describes the main elements of the NEHG in the context of the EU Fit for 55 Package. Moreover, the blog post analyses whether the Austrian ecological tax reform could serve as a blueprint for other member states planning to implement a carbon pricing instrument.

The carbon pricing instrument aims to cover emissions outside the European Emission Trading Scheme (EU ETS). In the beginning, mainly CO_2-emissions in the building and transport sectors will be covered by the NEHG. Looking at the allocation of CO_2-emissions outside the EU-ETS this makes sense because the transport and building sectors are responsible for approximately 40 % (30 % road sector 10 % buildings) of the total CO_2-emissions in Austria. Particularly, the transport sector is responsible for many emissions in Austria because of heavy traffic transit routes in Tyrol.[1]

The NEHG **is designed as an emission trading scheme and not as a carbon tax**. However, during its initial phase, the NEHG will have a fixed price phase from July 2022 until 31 December 2025. The fixed prices will gradually increase from € 30 in 2022, to € 35 in 2023, € 45 in 2024 and € 55 in 2025 per tonne CO_2. In addition to that, the maximum number of available allowances is not limited in the initial phase. This will change with the market phase, at the beginning of 2026. Yet, the law contains no further provisions on the concrete design of the market phase. More details are expected to follow after the evaluation of the NEHG at the end of 2024. This evaluation is stipulated by Art. 19 of the NEHG. Part of the evaluation is the determination of the specific form of the market phase of the NEHG.

Although the NEHG does not establish a carbon tax, the carbon pricing instrument **follows in central parts the logic of existing energy taxes** (fuel tax, coal tax, and natural gas tax) that are based on the Energy Taxation Directive (ETD). Thus, if a certain event is taxable under the existing energy taxes, an obligation to buy allowances arises under the NEHG. Taxable events under energy taxes are the production, importation, or release of energy products from a tax warehouse in Austria or the supply of coal and natural gas to consumers. In practice, only a limited number of energy distributors and oil companies are responsible for the payment of energy taxes, while the broad crowd of consumers is usually outside of their personal scope. Following the same logic as energy taxes, the distributors of energy products (upstream) are subject to the NEHG as intermediaries to the emitters, the number of participants to the NEHG thus being relatively low. The NEHG, therefore, differs from the EU ETS under which the emitters (operators of installations) are subject to the instrument (downstream). Furthermore, only energy products listed in Annex 1 NEHG are subject to the NEHG. The list of covered energy products includes, among others, petrol, diesel, heating oil, coal, natural gas. The exhaustive list of covered products could be expanded with a regulation in the future. Electricity is not subject to the NEHG because power plants or other installations above 20 MW of thermal output are covered by the EU ETS.

The implementation of the NEHG is flanked by several measures to reduce unwanted effects of carbon pricing instruments. For example, the Austrian government implements a so-called "**regional climate bonus**", a sort of regionalized climate dividend, which will be paid to all citizens with a primary residence in Austria as a compensatory measure for the novel carbon price. The amount of the regional climate bonus depends on the place of residency of the recipient. Citizens living in the countryside receive a higher amount of the regional climate bonus (up to € 200/year) than citizens living in urban areas (€ 100/year in Vienna). The basic idea is that citizens living in urban areas have better access to public transport than citizens living in the countryside. The regional climate bonus shall increase in case carbon prices rise in the future. The NEHG also contains compensatory measures for businesses. For example, agricultural and forestry undertakings will get a lump-sum reimbursement for additional costs induced by the NEHG based on the type of usage. Specific sectors of the economy which are particularly hit by the NEHG and exposed to risks of **carbon leakage** will be refunded partially for the additional burden resulting from the carbon price. This includes especially energy-intense industries who are, pursuant to Article 10b of Directive 2003/87/EC, deemed to be at risk of carbon leakage. In addition to that, companies that are particularly affected by the NEHG (e.g. in the transport sector) can also apply for partial refund of the carbon price to avoid hardship cases.

The ecological reform also includes **accompanying measures in the income tax act, corporate income tax act, and electricity tax**. For example, the Austrian government lowered income tax to reduce the taxation of labor substantially. Moreover, the government increased special tax incentives to compensate for the additional burden for families with children. In addition to that, the government lowered the corporate income tax rate gradually from 25 % to 23 % in 2024. Starting from 2023 corporations can also deduct 5 % (max 1mio €) of their investments in ecological measures from their profits as a special allowance in addition to a new investment tax credit of 10 %. As a further measure, the thermal renovation of houses can be deducted partially from income tax. Furthermore, self-produced and self-consumed electricity from renewable sources (so far only for photovoltaic) will be exempt from the electricity tax without any quantitative limits. All those measures will contribute to reducing the tax ratio in Austria.

The new role of upstream emission trading schemes

Prior to the Austrian NEHG, the idea for an upstream emission trading scheme was already picked up by the German government in 2019. As part of the Climate Action Programme 2030, Germany introduced its **Fuel Emission Trading Act** (Brennstoffemissionshandelsgesetz – BEHG) which entered into force in 2021. The Fuel Emission Trading Act served as a model for the design of the NEHG, which has strong similarities to the novel carbon pricing instrument in Germany. Similar to the Austrian NEHG, the German Fuel Emission Trading Act is closely tied to the taxable events of the energy tax in Germany and the carbon price is fixed in the initial phase.

However, not only Austria was inspired by Germany. In July 2021 the **European Commission** presented its Fit for 55 package, which includes several legislative proposals in various areas to achieve the EU climate targets for 2030. One central piece of the package is the revision of the Emission Trading Directive. One of the key points of the reform is the Commission's proposal to cover the **road transport and buildings sectors under a separate emission trading scheme**, which follows the logic of the German upstream approach.[2] According to the proposal, the expansion to buildings and road transport shall fully enter into force in 2026. The obligation to buy allowances arises at the moment when a taxable event under the energy taxes occurs. According to the proposal, the allowances will be auctioned. Therefore, there will be no fixed price phase at the beginning. However, there will be a market stability reserve to ensure stability in the price development of the allowances.

The cap reduction factor from the proposed emission trading scheme will enter into effect in 2026.[3] The maximum amount of allowances for each Member State follows the effort-sharing regulation. The effort-sharing-regulation is a legally binding instrument that sets emission reduction targets for each Member State of the EU. This will ensure an emission reduction of 43 % for both sectors[4] in 2030 compared to 2005.[5] Against this background, it is unclear which (practical) implications the implementation of a separate EU ETS will have on the obligations of the member states in the effort sharing regulation. The new, separate, EU ETS will be a harmonized instrument responsible for the emissions reduction in the road transport and building sectors. Member States failing to reach their national emissions reduction targets under the Effort-Sharing Regulation could thus blame this new EU ETS directive for their failure. However, the Commission did not address this issue in its proposal for the Fit for 55 package.

Effects of the new role of upstream emission trading schemes on Austria's reform

Those developments at the EU level were crucial for the implementation of the NEHG. The Austrian government had also considered the implementation of a carbon tax but it would have been impractical from an Austrian point of view to introduce a carbon tax, with the knowledge that the EU is planning the expansion of the EU ETS by 2026. Indeed, it would not have been efficient to introduce a carbon tax only for the period between 2022 and 2026. It would not make much sense to have two carbon pricing instruments that cover the sectors road transport and buildings at once as it would result in a double carbon pricing situation between the national carbon tax and the EU ETS.

In short, Austria partly anticipates with the NEHG the above-mentioned EU upstream emission trading scheme for the road transport and buildings sectors proposed by the Commission. Moreover, developments at the EU level will be taken into account in the mandatory evaluation of the NEHG by the end of 2024 (Art 19 of the NEHG). Therefore, the NEHG already contains a potential implementation mechanism for the proposed introduction of a separate EU emission trading scheme for the sectors of road transport and buildings.

Open future of carbon taxes in the EU?

The Austrian ecological tax reform is a good case study of the current developments regarding carbon pricing in the EU. The European Commission has made several attempts to introduce a common EU wide carbon tax in the EU. For example, the Commission tried to implement a partial carbon taxation (via CO_2-related minimum levels of taxation) in the ETD in 2011. However, the proposal failed to get the required unanimous vote of the Council of the European Union.[6]

After several attempts, the **Commission has now changed its strategy**. Instead of a carbon tax, the Commission proposes an emission trading scheme. One decisive advantage of this approach is that emission trading schemes can be decided by an ordinary legislative procedure with **qualified majority**.[7] By that, the implementation of an emission trading scheme would become easier from a political point of view as **unanimity is not needed**. Moreover, part of the Fit for 55 package is also the recast of the ETD, to promote green technologies and to reduce outdated exemptions (e.g aviation). However, the proposal does not contain an attempt to implement carbon taxes anymore.

The shift in strategy shows that **emission trading schemes will gain more importance** in the EU's climate policy compared to energy and carbon taxes in the future. Against this background, Germany and Austria are the first Member States that have implemented an upstream emission trading scheme in the EU. In contrast, **the future of carbon taxes in the EU remains open** as there are no more attempts to harmonize them at the EU level. While the ETD would still allow Member States to apply carbon taxes at a national level for the sectors outside the EU ETS, it remains to be seen whether Member States having a carbon tax in force at the moment will maintain their carbon taxes in the future if the proposed separate emission trading scheme is introduced at an EU level. Otherwise, those Member States would have two overlapping carbon pricing instruments on the sectors outside the current EU ETS in force. It is, therefore, possible that the implementation of a separate emission trading scheme for the sectors road transport and building leads to the slow disappearance of carbon taxes in the EU.

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[1] Emissions from foreign vehicles that fill up their tanks in Austria are included in the Austrian emissions inventory.

[2] See Chapter IVa, COM(2021) 551 final.

[3] See COM(2021) 551 final, p 20.

[4] Road transport and building sector.

[5] See COM(2021) 551 final, p 19-20.

[6] See Art 113 Treaty on the Functioning of the European Union.

[7] See Art 192(a) Treaty on the Functioning of the European Union.

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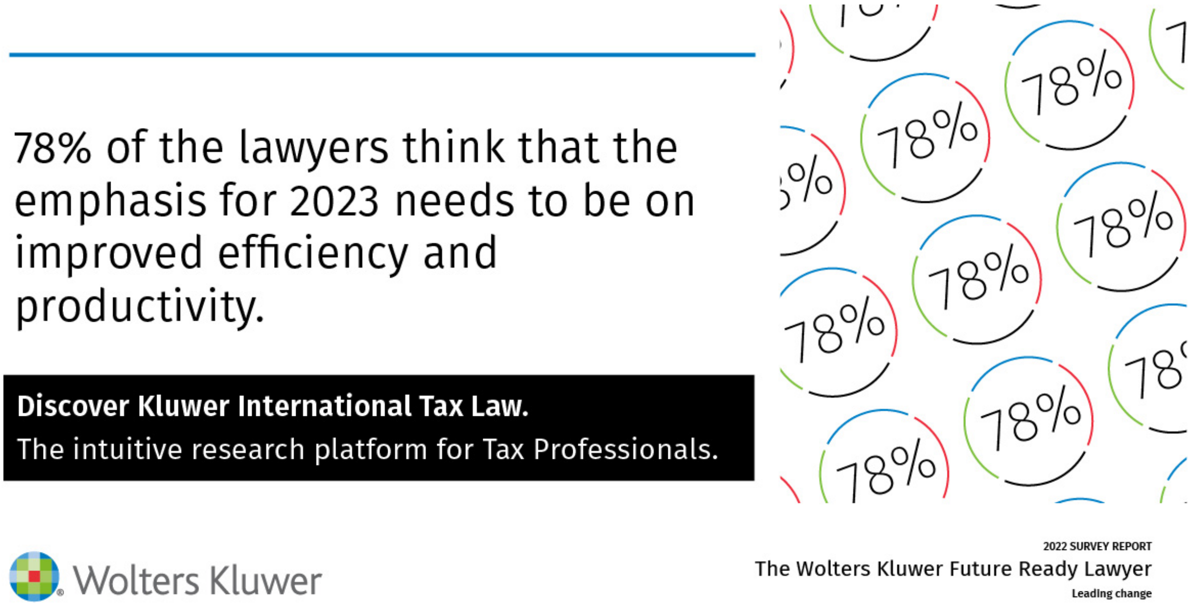

This entry was posted on Thursday, February 3rd, 2022 at 2:00 pm and is filed under Carbon pricing, Carbon Tax, Environment, EU, Fit for 55
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