EC proposes to address high energy prices through excess profits taxes and consumption reductions

22 September 2022

In brief

The European Commission (EC) published, on September 14, a proposal for a Council Regulation on an emergency intervention to address high energy prices.

The proposal includes four measures:

- An obligation for EU Member States to reduce their gross electricity consumption by 10% (until 31 March 2023),
- An obligation for EU Member States to reduce their gross electricity consumption by at least 5% during selected peak price hours (until 31 March 2023),
- A temporary revenue cap on electricity generators with lower marginal costs (such as renewables, nuclear, lignite and crude oil) until 31 March 2023, and
- A temporary mandatory solidarity contribution tax on 2022 excess profits generated from activities in the oil, gas, coal, and refinery sectors.

According to the EC, these measures seek, inter alia, to mitigate the impact of high electricity prices and protect consumers, while preserving the benefits of the internal market and a level playing field.

In detail

Temporary revenue cap on 'lower margin' electricity generators until 31 March 2023 (Article 6 and 7)

The proposed Regulation sets out an approach to recover excess revenues from electricity generators with lower marginal generation costs (see the below list of in-scope generation methods). To limit the revenue of these lower-cost generators, the EC has proposed a maximum market revenue cap of 180 EUR per MWh of electricity

produced. This cap is proposed to apply from no later than 1 December 2022 and remain in place until 31 March 2023. The market cap would not fix the price of electricity, but instead would limit the revenues earned by these lower-cost generators (with any excess revenue above the cap being surrendered to the EU Member State).

So as to preserve market stability, the revenue cap would apply to the following forms of electricity generation:

- renewable energy (including wind, solar thermal, solar photovoltaic, geothermal, hydropower without a reservoir, biomass fuel (excluding bio-methane) and other waste)
- nuclear
- lignite (or ‘brown coal’) and
- crude oil and other oil products.

EU Member States may elect to exempt some electricity generators where the power-generating facilities installed capacity is under 20 kW, or the generator is already subject to another form of revenue cap by the EU Member State. In addition, the proposal mandates that EU Member States shall use any surplus revenue (resulting from the cap) to support final electricity customers, so as to mitigate the impact of high electricity prices on those customers in a targeted manner.

Observation: It is not yet known how the proposed revenue cap, in conjunction with the expected additional financial support for final consumers, will impact the current electricity price pressure. Given the revenue cap is proposed to expire on 31 March 2023, we expect to see further debate around structural reform to the EU electricity generation market in the near future.

Temporary mandatory solidarity contribution tax on excess profits generated from activities in the oil, gas, coal and refinery sectors (Article 13)

The proposed Regulation introduces an exceptional mandatory solidarity contribution tax for the fossil industry applicable in all EU Member States and should apply from 31 December 2022 at the latest.

- *Basis for calculation of the solidarity contribution tax:* taxable profits in 2022 (fiscal year starting on or after 1 January 2022) from activities in the oil, gas, coal and refinery sector as determined under bilateral treaties or EU Member State’s national tax laws, which are above a 20% increase of the average taxable profits generated in the three fiscal years starting on or after 1 January 2019. A negative average annual result leads to average taxable profits being zero.
- *Taxpayers impacted:* EU companies and permanent establishments.
- *Tax rate applicable:* 33%. The preamble indicates that EU Member States remain free to apply a higher rate if they already apply a similar contribution, levy or tax.
- *Application:* for a period of one year after the Regulation enters into force (one day following the publication in the official EU journal), which should be no later than 31 December 2022.

The EU Member States shall use the proceeds from the contribution to facilitate financial support measures in a defined, transparent, proportionate, non-discriminatory and verifiable manner.

Observation: the solidarity contribution tax is clearly inspired by the national windfall taxes that some EU Member States already are developing to tax the excess profits of energy companies. This is already the case in Hungary,

Greece and Italy. The Czech Republic decides this month on its own windfall tax and Spain has already submitted a draft bill. Germany is also considering introducing a windfall tax. According to the EC, existing or planned national measures sharing similar objectives with the contribution shall comply with or complement the rules governing the contribution.

Legal basis and next steps

The legal basis of the proposal is Article 122 of the Treaty on the Functioning of the European Union. As such, the proposal requires a qualified majority vote in the Council to be approved. The proposed measures will be discussed at an extraordinary Council meeting scheduled for 30 September 2022.

If adopted, the Regulation will be binding on all EU Member States and thus implementation into national law would not be necessary. However, EU Member States retain the right to introduce more ambitious measures both in terms of demand reduction and the limitation of revenues of electricity producers, as long as they are proportionate, do not distort the functioning of electricity wholesale markets, do not jeopardise investment signals, and are in line with EU law.

Observation: The use of Article 122 to impose the solidarity contribution tax under the qualified majority vote procedure has raised questions as to whether this Article could be used more broadly to circumvent the unanimity requirement for other tax measures. Article 122 seems limited to quite extreme circumstances. Nevertheless, the language about acting “in a spirit of solidarity between Member States, upon the measures appropriate to the economic situation” could be expansively interpreted given the expressed dissatisfaction by some countries about the difficulty of getting unanimity in tax matters. This will be worth monitoring.

The takeaway

Prices for energy supplies such as oil, gas, coal, and crude remain high, resulting in increased electricity costs for European citizens. Uncertain supply chains (particularly for gas supplies) compound that risk and there are widespread fears of electricity outages for the coming winter. Politicians across Europe are mobilising to prevent the worst-case scenarios, both in individual Member States and now potentially collectively through the European Union.

The measures put forward in this proposal would take effect on an EU-wide basis, and with almost immediate effect. The measures would support an internal EU energy market that would, at least in theory, allow electricity to “*flow efficiently around Europe so that Member States can export surplus electricity to those who need it most.”* The proposal is stated to support the REPowerEU project.

It remains to be seen the extent to which Member States would support this EC initiative, because of the interplay with similar domestic measures, although the EC indicates that uncoordinated national measures could endanger the supply chain at the Union level.

Windfall taxes are meant to help fund extraordinary financing needs to compensate households for unprecedented high energy prices by taxing the ones that benefit from the high prices. Nevertheless one could question whether a windfall tax is the best option from a (tax) policy perspective. A windfall tax is not designed as a general excess profits tax (EPT) designed to tax economic rent.[1] Many countries already have an excess profits regime for the extractive sector for governments to share in profits generated by extracting minerals, oil, or gas. “Economic and legal arguments lend more support to general EPTs over sector specific EPTs,” according to the authors of the IMF Working Paper.[2] Why would a windfall tax indeed be justified in one sector of many in which profits fluctuate because of fluctuations in world market prices? Sectoral windfall taxes also raise a number of issues, like how to determine the companies in scope, how to determine what the excess profits is (unless one uses fictions this will be

very hard to determine), and what to do with extraordinary losses if world market prices drop heavily. From a broader perspective, taxing windfall profits in the energy and extractive industry arguably does not accelerate the energy transition. Would it be an option to design a system in which windfall profits would need to be employed for investments in the energy transition instead?

Let's talk

For a deeper discussion of how the proposal might affect your business, please contact:

Tax policy leadership

Stef van Weeghel, *Amsterdam*
+31 0 88 7926 763
stef.van.weeghel@pwc.com

Will Morris, *Washington*
+1 202 213 2372
william.h.morris@pwc.com

Edwin Visser, *Amsterdam*
+31 0 88 7923 611
edwin.visser@pwc.com

Tax policy contributors

Bob van der Made, *Belgium*
+31 6 130 96296
bob.vandermade@pwc.com

Niels Muller, *Netherlands*
+31 6 51 60 08 61
niels.muller@pwc.com

Jacomien van den Hurk, *Belgium*
+32 477 580602
jacomien.van.den.hurk@pwc.com

Tax policy editors

Phil Greenfield, *United Kingdom*
+44 0 7973 414 521
philip.greenfield@pwc.com

Chloe O' Hara, *Ireland*
+353 87 7211 577
chloe.ohara@pwc.com

Keetie van der Torren-Jakma, *Netherlands*
+31 6 1856 5973
keetie.van.der.torren-jakma@pwc.com

© 2022 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

---

[1] Excess Profit Taxes: Historical Perspective and Contemporary Relevance
Prepared by Shafik Hebous, Dinar Prihardini, and Nate Vernon, IMF WP/22/187
[2] Ibid, page 4