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PROPOSAL

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To:	Secretary-General of the Council of the European Union
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Subject:	Proposal for a COUNCIL IMPLEMENTING DECISION authorising Finland to apply a reduced rate of taxation to electricity supplied to certain heat pumps, electric boilers and recirculating water pumps, in accordance with Article 19 of Directive 2003/96/EC

Delegations will find attached document COM(2022) 219 final.

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Proposal for a

COUNCIL IMPLEMENTING DECISION

authorising Finland to apply a reduced rate of taxation to electricity supplied to certain heat pumps, electric boilers and recirculating water pumps, in accordance with Article 19 of Directive 2003/96/EC

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

Taxation of energy products and electricity in the Union is governed by Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity[1] (the 'Energy Taxation Directive', the 'ETD' or the 'Directive').

Pursuant to Article 19(1) of the Directive, in addition to the provisions laid down in particular in its Articles 5, 15 and 17, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce further exemptions or reductions in the level of taxation for specific policy considerations.

By letter dated 6 August 2021, followed by further correspondence of 4 November 2021, 26 January and 16 February 2022, the Finnish authorities requested authorisation to apply a reduced rate of taxation to electricity used to power certain heat pumps, electric boilers and recirculating water pumps. The requested period of validity is six years, from 1 January 2022 until 31 December 2027, which is within the maximum period allowed by Article 19 of the Energy Taxation Directive. The objective of this proposal is to grant that authorisation by means of a derogation valid for six years, as requested, until 31 December 2027.

Finland is seeking for an authorisation to apply the national rate provided for business use of electricity of 0.63 EUR/MWh (rate labelled "category II" under Finnish law which covers only certain business sectors[2]), which is above the ETD minimum rate for business use of electricity of 0.5 EUR/MWh[3], to the following: heat pumps and electric boilers that generate heat for the district heating network, heat pumps with a nominal thermal output of at least 0.5 MW not connected to the district heating network, and recirculating water pumps in geothermal heating plants. In that context, according to the information provided by the Finnish authorities, the measure should target both some specific business and non-business use of electricity[4]. The national rate applicable to electricity for non-business use (rate named "category I" under Finnish rules, covering everything else than category II, including households) is set at 22.53 EUR/MWh, well above the corresponding ETD minimum rate of 1 EUR/MWh[5].

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1 OJ L 283, 31.10.2003, p. 51–70.

2 The Finnish authorities explained that the lower ("category II") business-use electricity tax rate applied to sectors such asindustry, agriculture, mining and data centres.

3 Article 10(1) and Annex I, Table C, of the Directive.

4 In this regard, Finnish authorities underlined, for example, that while a housing cooperative can itself manage the heat pump, it is possible that the same housing cooperative can buy the heat pump service from an energy company; in terms of the objective of the measure, it would not be justified for the tax treatment to be different in those situations on the basis of whether the operator is a housing cooperative or an energy company. Moreover, the physical supply chains of electricity within a property are often very complex, as there are different actors in the same building (with one electricity connection) - often the same building has residential apartments and business premises. Therefore, in some situations, separating business and housing premises within the real-estate network in order to implement a tax reduction would be impossible. Finally, the Finnish authorities highlighted that a housing cooperative can sell the heat it generates back to the district heating network, and in this case, a housing cooperative can also have a business nature.

5 Article 10(1) and Annex I, Table C, of the Directive.

The reduction aims to provide incentives for the deployment and use of electrically powered heating generation that is otherwise heavily reliant on polluting fossil fuels or on biomass and to promote non-combustion heat production (as a heat source, for example heat pumps can use, among others, outdoor temperature, ground-source heat and deeper geothermal energy, sea and lake water and waste water heat; also different waste heat sources from industry, data centres and other cooling systems can be used as heat sources) in order to reduce emissions and to save fossil and renewable natural resources.

The reduced rate would apply to heat pumps and electric boilers in the district heating network, to heat pumps outside of the district heating network that have a nominal thermal output of at least 0.5 MW and to recirculating water pumps in geothermal heating plants. According to the reasoning provided by Finland, taxing all heat pumps and electric boilers at the lower rate would not be justified and well-grounded for several reasons.

Considering for example heat pumps, the ones of a smaller size -not covered by the requested measure- are deemed to be already very competitive. In addition, applying category II electricity tax for those ones would require separate measurement of electricity for the purposes at stake and registration of beneficiaries. There are more than 1.1 million heat pumps in Finland, so the quantity would be very large and the administrative burden significant for different parties.

Conversely, based on the estimations of the Finnish authorities for 2022, the chosen criteria would reduce the number of beneficiaries to less than one hundred.

The measure would apply to those beneficiaries, which would pay 2.19 cent/kWh less than the standard rate, resulting in EUR 10-15 million of tax expenditure, in the form of lower tax revenues (according to the estimations for 2022).

- **Consistency with existing policy provisions in the policy area**

Provisions under the Energy Taxation Directive

Taxation of electricity is governed by the Energy Taxation Directive. In particular, Article 10 and Annex I, Table C of that directive, provide for the relevant minimum levels of taxation, differentiated into business and non-business use, set out respectively at 0.5 EUR/MWh and 1 EUR/MWh.

Article 11 of the Directive contains among others the definition of ‘business use’ and allows Member States to limit the scope of the reduced level of taxation for business use.

Finland has limited the scope of the lower business-use electricity tax rate, the category II rate of 0.63 EUR/MWh, to certain business sectors, namely industry, agriculture, mining and data centres.

Other electricity consumption, such as electricity used by households, belongs to the tax category I, set at 22.53 EUR/MWh.

The proposed reduced tax rate of 0.63 EUR/MWh for electricity would cover heat pumps and electric boilers that generate heat for the district heating network; heat pumps with a nominal thermal output of at least 0.5 MW not connected to the district heating network, and recirculating water pumps in geothermal heating plants would be entitled to the lower electricity tax.

For reasons of consistent and uniform application and of practical implementation, the lower electricity tax rate would apply not only to some business use but also to some specific non-business use, which should be subject to the higher level of taxation under the Finnish category I rate of 22.53 EUR/MWh. In this respect, to further substantiate their request, Finnish authorities highlighted also that Article 15(1)(h) of the Directive allows Member States to apply an exemption in the level of taxation of electricity used by households, while in their country electricity taxation for households would remain very high[6] (category I of the Finnish tax rates is set at 22.53 EUR/MWh, much above the EU minimum level). The requested national tax rate would be however above the ETD minimum level of taxation for business use.

Article 19(1), first subparagraph, of the Directive reads as follows:

In addition to the provisions set out in the previous Articles, in particular in Articles 5, 15 and 17, the Council, acting unanimously on a proposal from the Commission, may authorise any Member State to introduce further exemptions or reductions for specific policy considerations.

The possibility to introduce a tax relief (reduced rate of electricity tax) for electricity supplied to heat pumps, electric boilers and recirculating water pumps, that meet certain conditions, can be envisaged under Article 19 of the Energy Taxation Directive, since its purpose is to allow the requesting Member State to introduce a further reduction for specific policy considerations. Supporting the electrification of the heating end-use sector and promoting non-combustion heat production in order to reduce emissions and to save fossil and renewable natural resources can be considered such specific policy considerations. Finland's goal is to become climate neutral by 2035. The requested measure would foster the achievement of that goal.

Finland requested for the measure to be applicable for six years (starting from 1 January 2022), the maximum period allowed by Article 19(2) of the Directive. In principle, the period of application of the derogation should be long enough to encourage investment in the targeted electrically powered heating solutions. That period will provide the maximum possible legal certainty for the relevant investments.

However, the derogation should not undermine future developments of the existing legal framework and should take into account the current revision of the Energy Taxation Directive and a possible adoption by the Council of a legal act based on the Commission's proposal for the recast of the Energy Taxation Directive[7].

Under those circumstances, while it appears appropriate to grant the authorisation for the requested period, the validity of the derogation should be made subject to the entry into

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6 The same authorities observed that in their country, approximately one half of electricity is consumed in the higher, category I, tax and households account for slightly more than one half within the tax category. The proposed tax change would conversely concern about 1% of the total tax base of electricity taxation in the country.

7 Proposal for a Council Directive restructuring the Union framework for the taxation of energy products and electricity (recast), 14.7.2021, COM(2021)563 final 2021/0213 (CNS). In the context of the Fit for 55 package, the proposal aims, among others, at fostering electrification and the use of more sustainable energy sources; moreover, it keeps the current possibility for Member States to ask for derogations.

application of general provisions on the matter, at a point in time earlier than 31 December 2027.

State aid rules

The envisaged reduced tax rate of EUR 0.63 per MWh is above the EU minimum level of taxation for electricity for business use pursuant to Article 10 and Annex I, Table C, of Directive 2003/96/EC.

The measure may constitute State aid in accordance with Article 107(1) of the TFEU. Since the reduced rate is above the EU minima, the measure would be covered by Article 44 of Regulation 651/2014/EU (the General Block Exemption Regulation)[8]. Upon expiry of the period of validity of the General Block Exemption Regulation on 31 December 2023 the aid remains exempted during an adjustment period of six months (see Article 58(4) of the General Block Exemption Regulation). The decision is without prejudice to the applicable State aid rules during the period covered by the derogation.

- **Consistency with other Union policies**

Environment and climate change policy

The requested measure aims at promoting non-combustion heat production in order to reduce emissions and to save fossil and renewable natural resources. In its Article 13, Directive 2008/50/EC on Ambient Air Quality[9] requires Member States to ensure that the levels of several air pollutants are kept below the limit values, target values and other air quality standard established in the Directive.

Moreover, Finland's country specific electricity mix consists mostly of renewable (47%) and nuclear electricity (35%)[10], both of which are zero or low-carbon. Therefore, it is expected that further electrification of large-scale heating applications will result in significant environmental and climate benefits.

Hence, the measure is compatible with EU environment and energy policies, most notably the EU Green Deal, the Fit for 55 package promoting electrification, and the 2050 long-term decarbonisation agenda, in which electrification plays a central role.

Energy policy

The measure would contribute to realising the ambitions of the EU Green Deal, especially in the context of the EU's Strategy for Energy System Integration[11].

The EU Strategy for Energy System Integration provides the framework for the green energy transition. The current model where energy consumption in transport, industry, gas and buildings is happening in 'silos' - each with separate value chains, rules, infrastructure,

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8 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, p. 1–78).

9 Directive 2008/50/EC of the European Parliament and of the Council of 21 May 2008 on ambient air quality and cleaner air for Europe (OJ L 152, 11.6.2008, p 1).

10 European Commission: Energy statistical country datasheets

11 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Powering a climate-neutral economy: An EU Strategy for Energy System Integration (COM/2020/299 final of 8.7.2020).

planning and operations - cannot deliver climate neutrality by 2050 in a cost efficient way. The requested measure would foster the integration of the heating end-use sector with other end-use sectors. In line with the Strategy, the requested measure would also lower the costs of innovative solutions that have to be integrated in the EU's energy system. The requested measure would directly contribute to two of the three pillars of the EU Strategy for Energy System Integration.

Firstly, a more 'circular' energy system, with energy efficiency at its core. The strategy identifies concrete actions to apply the 'energy efficiency first' principle in practice and to use local energy sources more effectively in buildings or communities. There is significant potential in the reuse of waste heat from industrial sites, data centres, or other sources, and energy produced from bio-waste or in wastewater treatment plants. The measure requested by Finland aims to support, among others, the use of waste heat from sources explicitly listed by the Strategy.

Secondly, a greater direct electrification of end-use sectors. As the power sector has the highest share of renewables, electricity should be increasingly used where possible, for example, for heat pumps in buildings. The measure requested by Finland aims to support electrically powered application, in line with the Strategy.

That measure would foster energy system integration since district heating networks offer more flexibility and ability to store electric energy in the form of heat as compared to separate building heating solutions. Finland already has a well-developed district heating infrastructure, which can serve that purpose.

The requested derogation to use a lower tax rate would also apply among others to certain electric boilers. Such reduction can also contribute to energy system integration and to system integration of renewable electricity. Electric boilers can be used for producing heat into district heating networks especially in the times when there is surplus of electricity and the electricity price is low. That allows, for example, the use of wind power for district heat production. The small investment costs of the electric boilers enable profitability with only few operating hours and heat production can take place only when there is oversupply of electricity. That can contribute to maintaining the stability of the electricity system. The impact of the electricity taxation to the heat production cost is currently significant and, as said before, it could be a good moment to use those appliances. Electric boilers can be combined with heat storage capacity, which allows storage of excess power as heat.

The measure requested by Finland is also in line with the EU's Strategy on Heating and Cooling[12] which recalls the benefits of replacing fossil fuel based heating solutions by heat pumps and waste heat use. The Strategy states that heat pumps can turn one unit of electricity into three or more units of heating or cooling.

The above mentioned benefits are also highlighted in the context of the EU's Energy Efficiency Directive and specifically by the Commission Recommendation on the content of

[12] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: An EU strategy on heating and cooling (COM/2016/051 final of 16.2.2016).

the comprehensive assessment of the potential for efficient heating and cooling under Article 14 of Directive 2012/27/EU[13] (the Energy Efficiency Directive).

Internal market and fair competition

The measure would be open to all EU operators without discrimination. The reduced rate would apply to all heat producers using heat pumps and electric boilers that generate heat for the district heating network, heat pumps with a nominal thermal output of at least 0.5 MW used outside the district heating network and recirculating water pumps in geothermal heating plants.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

• Legal basis

Article 19 of Council Directive 2003/96/EC.

• Subsidiarity (for non-exclusive competence)

The field of indirect taxation covered by Article 113 of TFEU is not in itself within the exclusive competence of the European Union within the meaning of Article 3 of TFEU.

However, pursuant to Article 19 of Directive 2003/96/EC, the Council has been granted an exclusive competence, as a matter of secondary law, to authorise a Member State to introduce further exemptions or reductions within the meaning of that provision. Member States cannot therefore substitute themselves for the Council. As a result, the principle of subsidiarity is not applicable to the present implementing decision. In any event, since this act is not a draft legislative act, it should not be transmitted to national Parliaments pursuant to Protocol No 2 to the Treaties for review of compliance with the subsidiarity principle.

• Proportionality

The proposal respects the principle of proportionality. The tax reduction does not exceed what is necessary to attain the objective in question.

• Choice of the instrument

The instrument proposed is a Council implementing decision. Article 19 of Directive 2003/96/EC makes provision for this type of measure only.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

• Ex-post evaluations/fitness checks of existing legislation

The measure does not require the evaluation of existing legislation.

• Stakeholder consultations

This proposal is based on a request made by Finland and concerns only this Member State.

[13] Commission Recommendation (EU) 2019/1659 of 25 September 2019 on the content of the comprehensive assessment of the potential for efficient heating and cooling under article 14 of Directive 2012/27/EU

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

This proposal concerns an authorisation for an individual Member State upon its own request and does not require an impact assessment.

Across the EU, the heating end-use sector is generally reliant on fossil fuel combustion. According to Eurostat data (NRG_BAL_PEH) 70% of derived heat is produced from fossil fuels. Among others, heat pumps are electrically powered alternatives to fossil fuel based heat generation. As Finland's country specific electricity mix consists mostly of renewable (47%) and nuclear electricity (35%), both of which are zero or low-carbon, it is expected that further electrification of large-scale heating applications will result in significant environmental benefits. Furthermore, those benefits can provide a contribution to achieving the Union's environmental and climate objectives.

Concerning particularly heat pumps and district heating, according to a study commissioned by the Finnish government, in 2020 in Finland, 11% of the total district heating production was based on waste heat sources. Unused excess heat and waste heat potential is estimated to be significant, but the utilization of different heat streams in district heat production is often challenging and the feasibility and profitability of waste heat utilization varies considerably. The electricity cost of heat pumps is one central factor impacting the profitability of heat pump investment and use. With the current electricity tax level in Finland, the share of electricity tax is a significant part of the total electricity cost. Based on the case studies analysed, the cost effect of the electricity taxation is about 10-20% of the total costs of a heat pump, when both operating and investment costs are taken into account. If the heat pumps used in district heat production are transferred into the lower category II electricity tax, as requested by Finland, this would significantly decrease the average production cost of different heat pump solutions. That is likely to increase the interest to invest in heat pumps. Currently the heat production solutions based on fuel use, especially local biomass, are typically more cost efficient compared to heat pump solutions. As Finland is decreasing the use of fossil fuels and peat, it would mean that the use of biomass in district heating production increases rapidly. Increasing use of waste heat and different heat pump solutions could reduce the increase in the biomass use.

The study furthermore highlights that waste heat utilization often contains uncertainties related to the security of supply of the heat, potential counterparty risks and risks related to investment costs and availability of the heat. In addition, some technologies, like geothermal energy production, are still in piloting phase. Electricity tax decrease for the heat pumps would improve the competitiveness of heat pumps compared to other heat production technologies, and could partly compensate other risks and uncertainties connected to the heat pump investments.

Finally, as observed by Finnish authorities, the measure involves questions that are technically difficult to implement. The measure should be implemented in a well-targeted, neutral and fair manner. According to their estimations, the budgetary expenditure is expected to range from EUR 10 to 15 million in 2022.

- **Regulatory fitness and simplification**

The measure does not provide for a simplification. It is the result of the request made by Finland and concerns only this Member State.

- **Fundamental rights**

The measure has no bearing on fundamental rights.

4. BUDGETARY IMPLICATIONS

The measure does not impose any financial or administrative burden on the Union. The proposal therefore has no impact on the budget of the Union.

5. OTHER ELEMENTS

- **Implementation plans and monitoring, evaluation and reporting arrangements**

An implementation plan is not necessary. This proposal concerns an authorisation for a tax reduction for an individual Member State upon its own request. It is provided for a limited period. The applicable tax rate would be above the minimum level of taxation for electricity for business use set by the Energy Taxation Directive. Therefore, it would respect the minimum set by the Directive for business use. The measure can be evaluated in case of a request for a renewal after the expiration of the initially granted validity period.

- **Explanatory documents (for directives)**

The proposal does not require explanatory documents on the transposition.

- **Detailed explanation of the specific provisions of the proposal**

Article 1 stipulates that Finland will be allowed to apply a reduced taxation rate to electricity supplied to the following applications: heat pumps and electric boilers that generate heat for the district heating network, heat pumps with a nominal thermal output of at least 0.5 MW outside of the district heating network, and recirculating water pumps in geothermal heating plants. The tax rate must not be less than EUR 0.50 per MWh, i.e. the minimum level of taxation for electricity for business use set by the Directive.

Article 2 stipulates that the authorisation requested is granted with effect from 1 January 2022, until 31 December 2027, which is the maximum period allowed by the Directive.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity[14], and in particular Article 19 thereof,

Having regard to the proposal from the European Commission,

Whereas:

(1) By letter of 6 August 2021, Finland requested authorisation to apply a reduced rate of taxation to electricity supplied to heat pumps and electric boilers that generate heat for the district heating network, to heat pumps with a nominal thermal output of at least 0.5 MW not connected to the district heating network, and to recirculating water pumps in geothermal heating plants, pursuant to Article 19 of Directive 2003/96/EC. Additional information and clarifications in support of the request were provided by the Finnish authorities on 4 November 2021, 26 January 2022, and 16 February 2022.

(2) Through the envisaged reduced rate, Finland aims at increasing the electrification of the heating end-use sector and promoting non-combustion heat production in order to reduce emissions. The increased use of electrically powered heating installations is expected to result in environmental and climate benefits.

(3) Allowing Finland to apply a reduced rate of taxation to electricity supplied to heat pumps and electric boilers that generate heat for the district heating network, to heat pumps with a nominal thermal output of at least 0.5 MW not connected to the district heating network, and to recirculating water pumps in geothermal heating plants, does not go beyond what is necessary to increase electrification of the heating end-use sector. Such heating installations promote the green transition and decrease the use of heat production based on burning fuels. Those installations are not yet competitive on the market, and the measure limits the administrative burden. Therefore, the measure is unlikely to lead to significant distortions in competition during its lifetime and will thus not negatively affect the proper functioning of the internal market.

(4) Each authorisation granted under Article 19(2) of Directive 2003/96/EC is to be strictly limited in time. In order to ensure that the authorisation period is sufficiently long so as not to discourage relevant economic operators from making the necessary investments, it is appropriate to grant the authorisation from 1 January 2022 until 31 December 2027. However, in order not to undermine future general developments of

[14] OJ L 283, 31.10.2003, p. 51.

the existing legal framework, it is appropriate to provide that, should the Council, acting on the basis of Article 113 or any other relevant provision of the Treaty on the Functioning of the European Union, introduce a modified general system for the taxation of energy products and electricity to which this authorisation would not be adapted, this authorisation should cease to apply on the day on which those general rules become applicable.

(5) In order to enable installation operators to pursue the promotion of heat pumps and electric boilers that generate heat for the district heating network, heat pumps with a nominal thermal output of at least 0.5 MW not connected to the district heating network, and recirculating water pumps in geothermal heating plants, it should be ensured that Finland may apply the tax reduction, as requested, with effect from 1 January 2022.

(6) This Decision is without prejudice to the application of Union rules regarding State aid,

HAS ADOPTED THIS DECISION:

Article 1

Provided that the minimum level of taxation referred to in Article 10 of Directive 2003/96/EC, as set out for business use under Annex I, Table C, to that Directive, is respected, Finland is authorised to apply a reduced rate of taxation to electricity supplied to any of the following:

a) heat pumps and electric boilers that generate heat for the district heating network;

b) heat pumps with a nominal thermal output of at least 0.5 MW not connected to the district heating network;

c) recirculating water pumps in geothermal heating plants.

Article 2

This Decision shall apply from 1 January 2022 until 31 December 2027.

However, should the Council, acting on the basis of Article 113 or any other relevant provision of the Treaty on the Functioning of the European Union, introduce a modified general system for the taxation of energy products and electricity to which the authorisation granted in Article 1 of this Decision would not be adapted, this Decision shall cease to apply on the day on which those general rules become applicable.

Article 3

This Decision is addressed to the Republic of Finland

Done at Brussels,

For the Council
The President