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Documento de Trabajo
Serie Política de la Competencia
Número 54 / 2016

Energy Taxation and State Aids: Analysis of Comparative Law

Marta Villar Ezcurra
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Prof. Dr. Marta Villar Ezcurra, Prof. Dr. Janet E. Milne

This document has been subjected to peer review. The scientific committee is composed of academic doctors from European universities and tax expert members of the he Institute of Fiscal Studies (Spain).

This work is part of the research project Energy taxation and State aid control: Looking for a better coordination and efficiency (ETSA-CE), coordinated by Prof. Dr. Marta Villar Ezcurra, Ref. 553321-EPP-1-2014-1-ES-EPPJMO-PROJECT.

It is also part of the research project "Fiscalidad de la energía: lucha contra el cambio climático versus competitividad", coordinated by Prof. Dr. Iñaki Bilbao Estada and Prof. Dr. Marta Villar Ezcurra, Ref: DER 2014-58191-P (Ministerio de Economía y Competitividad).

The researchers who have contributed to this paper with the sections on Brazil and China are Prof. Dr. Marcos André Vinhas Catão and Prof. Dr. Yan Xu.

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Instituto Universitario de Estudios Europeos
Avda. del Valle 21, 28003 Madrid
www.idee.ceu.es

ISBN: 978-84-16477-46-3
Depósito legal: M-37447-2016

Maquetación: Servicios Gráficos Kenaf s.l.

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1. Introduction

1.1. Setting the Context for the research activity

The limits on states' power to use tax incentives to achieve green energy goals, both in Europe, the US, or elsewhere, are particularly important in an era when countries and their member states are confronting the challenges of climate change. As states designing policy instruments to reduce greenhouse gas emissions, they must grapple with the question of how to achieve their environmental goals without violating legal rules designed to protect internal markets.

The issue of competitiveness for trade purposes constantly arises at the global, national and sub-national levels, and the law addresses these issues in a variety of ways. International agreements, such as the trade regime administered by the WTO, set rules for competition among nations. Constitutions, treaties, and other governing laws define the structure of national governments and the allocation of powers among the national and subnational governments, including principles governing trade competition. At the same time, governments need to address environmental and energy challenges, using the powers that they have under their forms of government, including the power to tax. Environmental and energy issues intersect in a particularly strong and significant way in the arena of climate change given the need to reduce emissions from fossil fuels and shift to green energy practices. Yet trade and green energy objectives can conflict. Sometimes governmental policy instruments that promote green practices can skew market competition at the international, national or sub-national level. For example, they may intervene in the market by providing subsidies to encourage renewable energy and energy conservation or protect industries at risk during the transition to a greener economy.

The comparative analysis of different approaches can help countries to better understand their relative degree of freedom to send environmental signals through tax codes and how that degree of freedom affects their standing not only in national and global markets but also in meeting national and international climate change goals. It also allows evaluating the extent to which the EU's State aid rules limit that freedom. As Häberle points out, the comparative method of interpretation, so-called iuscomparatista, turns out to be the EU key as EU law is often a legal comparative exercise[1]. To compare different answers to the same question or problem may not only bring about to a better understanding of the effects of each solution (the theoretical aspect), but may also help to improve each individual system (the *de lege ferenda* aspect) by introducing it to foreign solutions it might adopt[2].

This paper considers comparative law and specifically how different selected legal regimes reconcile competitiveness and environmental goals on energy taxation. It focuses in particular on how legal rules governing competition affect the ability to use environmentally related tax expenditures that could help reduce reliance on fossil fuels and reduce greenhouse gas emissions. It considers the issue from the legal perspective of how different governmental constitutions or compacts regulate competition and how those fundamental institutional agreements influence the use of energy-related tax expenditures. As the EU and the US share the principle that states within their unions should not unduly interfere with the internal market, we will focus on this comparative analysis taking into account that each country takes a different approach

1 *See* Introduction to comparative tax law, edited by Claudio Sacchetto and Marco Barassi, Rubbetinno Università, 7 (2008).

2 *See* Jörg Manfred Mössner, Why and how to compare tax law, Ibidem (supra note 1), 14 (2008).

to executing this principle through case-law. A brief reference to WTO is made due to its interference in sovereign tax powers. For contrast, we also consider the legal regimes in Brazil and China given the importance of their market and their relevant position on the word trade. As discussed below, Brazil and China do not have legal limitations on their internal markets comparable to those in the EU and US. Thus, they illustrate how some countries at least in theory may have greater legal latitude to design energy tax policies. They also serve as reminders that energy-related markets do not play on an internationally level tax playing field and that analysts of State aid policy should keep the larger comparative picture in mind.

By way of background, it is useful to consider the various governmental goals at issue and the role of environmental tax incentives, expenditures or reliefs before delving into the case studies below. In the framework of the European Union, there is a need to balance security of energy supply, sustainability and competitiveness[3]. However, for purposes of our analysis, there are three fundamental governmental policy goals that are relevant: (i) achieving robust trade economies that will enhance economic and social welfare; (ii) fueling the economy with sources of energy and levels of energy usage that are environmentally sustainable; and (iii) achieving a level of energy security that will promote national and international stability and growth.

As suggested above, policies that advance one may run counter to others: Governmental policy instruments that encourage shifts away from fossil fuels may interfere with the otherwise free market, particularly at times when governments are trying to encourage major structural changes, such as increased reliance on new types of energy for environmental or energy security purposes.

Tax policies can play a role in these interventions in various ways. A carbon tax, for example, can place a price on carbon dioxide emissions from fossil fuels in order to reduce reliance on fossil fuels. A tax on motor vehicle purchases or annual vehicle registrations based on their fuel economy can encourage consumers to consider fuel economy. However, tax expenditures also can play significant roles. By their very nature, they can provide financial relief to taxpayers by reducing the tax burden otherwise due through tax exemptions, tax deductions, tax credits or reduced tax rates. In doing so, they can serve different policy goals. For example, a lower carbon tax rate for an energy-intensive industry can offer tax relief during the transition from fossil fuels to low or no-carbon fuels in order to preserve the industry's competitive stance and protect the economy. A tax credit for a windfarm can serve climate change goals and increase domestic energy security. Tax expenditures can also sit in different places within tax regimes. They may be embedded in an environmental tax, such as a carbon tax, or they may offer special incentives within an unrelated tax regime, such as an income tax, sales tax, or property tax.

This paper considers a range of energy-related tax expenditures that are or could be designed to reduce reliance on fossil fuels[4]. As indicated above, the ultimate question is how the EU and WTO rules and constitutional regimes governing competition in the case study countries affect the use of these tax measures on the energy sector. How do global trade agreements and different countries' legal compacts reconcile the desire to maintain open markets and the need to employ policy instruments to protect the environment, to reduce greenhouse gas emissions and to achieve other important targets for the energy sector as energy efficiency?

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3 *See* Pasquale Pistone and Iñaki Bilbao, The role of tax incentives on the energy sector under Climate Change´s challenges, Documentos de Trabajo. Serie Política de la Competencia No. 49/2015, 25 (2015).

4 They do not, however, address the issue of the repeal of existing tax expenditures that subsidize the production of fossil fuels. They focus on measures that are environmentally positive or are embedded in environmentally positive taxes.

The paper starts by discussing how the EU treaty, through its State aid rules, protects the internal market while also advancing the broader common public interest. This is the point of departure to be compared with other regimes. It then considers the WTO's rules balance the interests of market competitiveness and environmental goals served by tax instruments. At the national level, other parts of the paper analyze how the legal mainly governance regimes in the United States - but also Brazil and China - allocate the power to regulate trade between national and sub-national governments and how those compacts affect the ability to use green energy-related tax expenditures. The analysis finally compares these approaches with the EU's State aid rules, with the ultimate aim of determining the relative degree of freedom or constraint under different forms of government in different countries. This comparative assessment can help countries to evaluate how existing legal regimes affect their relative ability to both compete in international and national markets and achieve energy and climate change goals.

1.2. Tax power´s allocation and legal authority to control the internal market. A factual precognition to be considered

At a first approximation, the EU does not tax, spend, implement or coerce, and, in many areas it does not hold a legal monopoly of public authority. In the EU, Member States keep their tax powers and even in areas of the EU´s greatest fiscal activity (the common agricultural policy, structural funding and development aid), most public findings remain national.[5]

Taxation is typically an area in which the EU has few exclusive powers, mainly expressed in the Union Treaties in order to harmonize tax regulations, although many powers of taxation straddle the areas of shared competences between the European Union and the Member States.[6] Some multilateral agreements cover trade and investment in particular sectors and impose obligations concerning taxation in the sectors covered.[7] In contrast, Article 4 of the Treaty on European Union (TEU) enumerates the shared competences between the European Union and the Member States, several of which are also relevant to the major objectives of the Union: internal market, economic, social and territorial cohesion, environment, transport, trans-European networks and energy. The competition rules which are, of course, the core of this internal market, are the exclusive domain of the Union. In addition, the Union already has extensive legislation in place with respect to the internal market. Therefore, there is no doubt that the centre of gravity of the legislative power with respect to the internal market lies with the Union but tax power´s allocation lies with the States.

The energy taxation regime in the EU is foreseen in Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.[8] This legal instrument sets minimum rates of taxation applicable to energy products when used as motor or heating fuels and to electricity. In this sense, Member States are prohibited from applying lower levels of taxation than those foreseen in the Directive. The Energy Taxation Directive is closely related to the State aids regime, since it includes exemptions and authorises Member States to grant tax incentives.[9]

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5 Moravcsik, Andrew, Reassessing legitimacy in the European Union. JCMS: Journal of common market studies, vol. 40, no 4, 603-624 (2002).

6 *See* Frans Vanistendael, Federalism and the Euro Crisis, 3 World Tax Journal 10, 408-409 (2011).

7 Hugh J. Ault and Jacques Sasseville, Taxation and Non-Discrimination: A reconsideration, World Trade Journal 22, 120 (2010).

8 Council Directive 2003/96/EC of 27 October 2003, restructuring the Community framework for the taxation of energy products and electricity (OJ L 283, 31.10.2003). The Proposal for a Council Directive amending Directive 2003/96/EC (COM (2011) 169/3) was given up (OJ C 80/17, 7.3.2015).

9 For further information about this topic *see* Marta Villar Ezcurra, EU State Aid and Energy Policies as an Instrument of Environmental Protection: Current Stage and New Trends. European State Aid Law Quarterly (4), 611-620 (2014) and Marta Villar Ezcurra, State Aids and Energy Taxes: Towards a Coherent Reference Framework. Intertax 41 (6-7), 340-350 (2013).

In the US[10], both the federal government and state governments have relatively broad powers to tax. Under the US constitution, states retain the power to tax, but the constitutional compact also gives Congress the power to impose taxes.[11] Some constitutional provisions provide for coordination between the two levels; for example, the states cannot use their taxing authority in a manner that interferes with interstate commerce.[12] Nevertheless, the constitution's generally permissive approach gives both federal and state governments relatively wide latitude to pursue tax policies, including environmental tax policies. In addition, the federal government can use its taxing power to achieve not only fiscal goals but also regulatory goals,[13] a principle that is important to the potential role of environmental taxes.

Each level of government may nonetheless choose to impose its own legal limits on its taxing power. The federal government has adopted statutory budget rules that influence tax legislation, in particular tax expenditures that will result in foregone revenue. By law, Congress should find new revenue to offset the cost of revenue-losing provisions, such as tax preferences, unless the measures are required for emergency purposes.[14] Hence, federal budget rules can create fiscal discipline over the adoption of new tax preferences. Conversely, they may also provide a motivation to pursue tax measures that will generate revenue to achieve budget neutrality. States can also limit their abilities to tax. For example, California amended its constitution to require that all new taxes require an affirmative vote of two-thirds of the state legislature or majority vote of the general public, a significant procedural barrier to new taxes.[15]

Even with these limits in mind, it is apparent that governments in the United States are not subject to restrictions comparable to those that apply in the European Union. If one analogises the US federal government to the EU and the US states to the EU Member States, the federal government can act without the restraint of the EU's unanimity rule for tax measures, and the US states are not bound by federal tax directives or State aid rules. Or if one analogises the US federal government to the EU Member States, given that each is a national authority, the US federal government operates under far fewer restraints than its EU counterparts.

As the US, many jurisdictions in Latin America are federations, such as the two most important countries in the Mercosur region, Brazil and Argentina.

Brazil is a federation where subnational governments have the right to impose taxes in accordance with articles 153 to 156 of the Constitution issued in 1.988. Considering that fiscal federalism is concerned with the balance of subnational public duties and the respective power to tax, the Brazilian Constitution has distributed the different applicable taxes based on such division. In this scenario, subnational governments encompass the central government (*União Federal*), States (*Estados*) and Municipalities (*Municípios*) as well the District Capital (*Distrito Federal*). Following articles 153 to 156, which split tax competences among subnational governments, articles 157 to 159 of the Brazilian Constitution, establish a mechanism in which central government and states transfer tax revenues to municipalities based in some parameters including environmental policies.[16]

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10 *See* Janet E. Milne, Energy Tax Incentives: United States Perspectives, In: Pistone P and Villar M (eds) Energy taxation, environmental protection and State aids: Tracing the path from divergence to convergence, IBFD, Amsterdam, 65-97 (2016).

11 *See* generally Jasper L. Cummings, Jr., *The Supreme Court, Federal Taxation, and the Constitution* (American Bar Association 2013), 79-106.

12 *See* generally id. at 100-102.

13 See, e.g., National Federation of Independent Business v. Sebelius, 132 S. Ct. 2566 (2012).

14 Pay-As-You-Go Act of 2010, P.L. 111-139. The rules are enforced in part through the ability of members of Congress to raise "points of order." *See* James V. Saturno, Points of Order in the Congressional Budget Process (Congressional Research Service 2013).

15 Cal. Const. art. 13A, § 3.

16 *See* below item 5.2.

Brazilian tax system has some similar characteristics in comparison with other countries in the world. Central Government tax revenues are concentrated in income tax, taxes on trade and other regulatory taxes such as regulatory and excises taxes (*vg. Imposto sobre Produtos Industrializados, Imposto sobre Operacoes Financeiras; Contribuicoes Especiais*) and States and Municipalities have the right to impose movable and immovable property taxes like real estate and gift taxes. From a different standpoint, Brazil has one of the most complex and peculiar system in terms of indirect taxation. Hence, Central Government assesses a federal VAT, the State-Members collect a State VAT and the municipalities impose taxes on services. Additionally there are many regulatory taxes, especially the so-called "special contributions" (*contribuições especiais*) which has led to an overlapped system of indirect taxation.

In the last years a constitutional tax reform has been one of the priorities in the political arena. However, due to a lack of consensus between the central government, states and municipalities none of the constitutional bills sent to the Congress were approved. Since public demands have substantially increased with the expansion of the Brazilian economy, all subnational governments have significantly raised tax revenues. At the end of the day, this led to a situation by which Brazil has the highest tax burden in Latin America that corresponds to 35% of the national gross income.[17]

China, as a unitary state, has theoretically a highly centralized tax legislative system, where the elements of the basic system of taxation are enacted by the bodies of the national legislature (NPC and NPCSC). The local governments are in principle limited in their powers to make tax rules and policies. However, as it will be seen below, practice often differs from this scheme of allocation of tax powers.

1.3. Legal concepts and legal terms

A brief basic clarification of terms and concepts in the EU and the USA might be needed for the purposes of this comparative study. In this sense, in the EU sphere we will refer to State aids from a fiscal point of view, using the terms "tax incentive" or "tax reliefs". The concept of State aid is much wider, and includes subsidies and any other form of lightening companies' burdens.

In the US scope, the term used will be "tax expenditures", which refers to tax preferences. In the US, "tax preferences" is also used to refer to a variety of types of tax subsidies, including tax credits, accelerated depreciation and other deductions, and exclusions from income. As we will see later, the commerce clause analysis distinguishes between aid delivered through direct expenditures, which is not subject to dormant commerce clause scrutiny, and aid conveyed through tax expenditures, which is subject to constitutional review.

2. EU State aids rules and energy taxation

EU rules on State aids are of considerable importance to the energy sector given the traditionally high level of involvement of governments in energy production and supply. They continue to play a significant role with respect to ensuring a controlled transition from closed to open markets under competition. Indeed, in the field of taxation and other levies (fees and charges), State aid rules play a major role in the intervention practices of EU Member States.

[17] *See* http://www.valor.com.br/brasil/3946654/brasil-tem-maior-carga-tributaria-da-america-latina-diz-ocde.

The EU framework for energy taxation has a quite long history and currently it pivots around the Energy Taxation Directive (ETD) and its commitment of a minimum level of taxation in all Member States, raising the question of how State aids are considered within its scope.[18] One key aspect of the discussions of the ETD in the Council focused precisely on the State aid question, the connections between tax reductions and/or exemptions and EU State aid rules and that, compulsory or facultative nature of certain tax reductions and/or exemptions must be considered. If the tax exemption derives from a Community measure such a Directive, without leaving any scope for discretionary application at national level, the measure is not "imputable" to the State and cannot therefore be considered to be a State aid. The first condition that the aid must be imputable to the State, different from the need to be granted through State resources is hence not met.

However, it is clear that any kind of tax measure which certain undertakings may enjoy, including in the context of the energy taxation, should be checked - as any "aid"- objectively, against the notion of article 107 (1) TFEU under their well-known four circumstances: The measure has to be granted by the State or through State resources (first element); it has to favour an undertaking or the production of certain goods (second element); it has to be selective (the third and more complex criterion to prove); and it has to affect trade between Member States in such way that it leads to a distortion of competition (fourth element).

2.1. Definition and notification requirement of State aids in the field of energy taxation

Basically, the structure of EU State aid law consists of two main levels. At the first level, the general prohibition of State aid can be found in Article 107(1) of the Treaty of Functioning of European Union (hereinafter, TFEU) and it is developed in the definition of State aid. Article 107(1) states as follows:

> "Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market".

The second level is based on Article 107(2) and (3) TFEU. These two provisions provide for exemptions to the general prohibition on the granting State aids. Automatic justifications mentioned in paragraph 2 are declared to be compatible with the internal market and no discretion is possible.[19]

Conversely, regarding the list included in paragraph 3 concerning the discretionary justifications[20], as is settled law, the Commission *"enjoys a wide discretion, the exercise of which involves assessments of an economic and social nature which must be made within a Community -Union- context". The Court would here "restrict itself to determining whether the Commission has exceeded the scope of its discretion by a distortion or manifest error of assessment of the facts or by misuse of powers or abuse of process"*.[21] Among the activities referred to in

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18 *See* supra note 8.

19 Moreover, the exhaustive list regarding, in summary, "social aids", "disaster aids" and "German aids" *"must be construed narrowly". See* Case C-156/98, Germany v. Commission, Judgment of 19 September 2000, ECLI: EC:C:2000:467, para. 49.

20 The most important categories of exemptions are enumerated in paragraph 3 (a), (b), and (c) as follows: *"(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest".*

21 Case C-225/91, *Matra SA v. Commission*, Jugement of 15 June 1993, ECLI:EU:CE1993:239, paras. 24 and 25.

paragraph 3, c, the Commission has included aids related to environmental protection and energy. The Commission may, of course, decide to structure its discretion through the adoption of formal or informal regulatory acts.

Acting on the basis of Article 109 TFUE, the Council has granted the Commission the power to adopt block exemptions in a number of areas[22] and the Commission has used this power to adopt the General Block Exemption Regulation (hereinafter, GBER).[23] The current GBER and particularly its article 44 are greatly relevant for several energy taxes and environmental tax reliefs and a distinction has to be made between tax reliefs[24] covered by the GBER and those that have to be individually examined. As in addition to formal secondary law, the Commission has also introduced a range of soft law measures, which are generally labelled as "guidelines" or "communications" and these "guidelines" and "communications" informally structure the Commission's discretion. The Guidelines on State aids regarding environmental protection and energy 2014-2020 (EEAG), and in particular the more specific criteria to assess the necessity and proportionality in the case of tax reductions or exceptions of harmonized and non-harmonized environmental taxes, have to be taken into account.[25]

Regarding the respective powers of the Council and the Commission in the area of the harmonisation of legislation, on the one hand, and in the area of State aid, on the other, on *Euralluminia SpA* case,[26] the Court of Justice of the European Union (hereinafter, CJEU) held that in the State aid area, the Council powers must be interpreted and applied strictly and could not deprive the Commission of the right to exercise its powers.[27]

2.2. The Court of Justice of the European Union´s criteria

What constitutes an "aid" in with respect to ta[28] and parafiscal levies[29] in the energy sector depends on the CJEU interpretation based on a case-by-case approach. Such clarification is particularly important in view of the procedural requirements that stem from designation as aid and of the consequences where Member States fail to comply with such requirements. Each of the four mentioned elements of the State aid notion is analysed below.

a) Granted by the State and State resources – alternative or cumulative conditions?

The wording of Article 107 *"granted by a Member State or through State resources"* suggests that the prohibition outlaws two forms of State interference. In a number of cases, the CJEU has come to clarify that the two

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22 One of these areas is "environmental protection". *See* Council of the European Union (2015), Article 1 (1)(a)(iii).

23 European Commission (2014) 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).

24 *See* Marta Villar Ezcurra, Pernille Wegener, Energy taxation and key legal concepts in the EU State aid context: looking for a common understanding. Documento de Trabajo Serie Política de la Competencia No. 50/2015. CEU Instituto Universitario de Estudios Europeos Universidad de San Pablo, Madrid (2015).

25 Communication from the Commission, Guidelines on State aid for environmental protection and energy 2014-2020, OJ 2014/C 200/01.Th EEAG uses some general concepts (i.e. "substantial increase in production costs" or "important sales reductions") without further elaboration.

26 *See* in the *Euralluminia SpA.* Case C-272/1P, Judgment of 10 December 2013, ECLI:EU:C:2013:812, and T-90/06 RENV, Judgment of the General Court of 21 March 2012, ECLI:EU:T:2012:134.

27 *See* the Judgment of 10 December 2013 (supra note 26), para. 50.

28 On this topic in general, *see* Wolfgang Schön, State Aid in the Area of Taxation. In: Hancher L, Ottervanger T, Slot Jan Piet (eds) EU State Aids, 4th edition, Sweet & Maxwell, London, 321-362 (2012).

29 Parafiscal levies are a frequent phenomenon on the electricity sector. On this topic *see* Marta Villar Ezcurra (2015) Avances en la relación de tributo ambientales y ayudas de Estado al hilo de la sentencia del Tribunal General de la Unión Europea de 11 de diciembre de 2014. Quincena Fiscal (14/2015), 151-181.

conditions are cumulative[30]. In other words, the distinction should not be made between *"aid granted by a Member State"* and *"aid granted through State resources"*, but rather - in a broad interpretation of the terms- between two separate and cumulative conditions: "the State imputability" and "the use of State resources".

This case-law was confirmed, among others, in PreussenElektra under the following terms: *"The distinction made in that provision between aid granted by a Member State and aid granted through State resources does not signify that all advantages granted by a State, whether financed through State resources or not, constitute aid but is intended merely to bring within that definition both advantages which are granted directly by the State and those granted by a public or private body designated or established by the State"*.[31] In the case at stake, German environmental legislation obliged electricity supply undertakings to purchase renewable energy from green producers at a price above the market value. The legislative system was designed to support energy producers and the Court denied the existence of an aid because *"the allocation of the financial burden arising from that obligation for those private electricity supply undertakings as between them and other private undertakings cannot constitute a direct or indirect transfer of State resources"*.[32] In PreussenElektra, the Court relied, in essence, on the fact that the German legislation did not present elements from which it could be inferred that there had been a direct or indirect transfer of State resources.[33]

Concerning the State imputability of the aid, the measure is regarded as not being imputable to the State to the extent that the implementation of the text was in compliance with a legal measure adopted at EU level with a clear and precise content. In the *Ireland and others v. Commission* case, which involved the application of different rates of excise duty on mineral oil used as fuel for alumina production, the Court stated that the *"non-payment (…) can be attributed to the Council´s decisions authorising the Italian Republic, Ireland and the French Republic to continue apply, until that day, full exemptions from excise duty"*.[34]

Regarding the condition of the "use of the State resources", the issue is to determine whether the aid is directly or indirectly financed by the Member State. CJEU case-law clarifies that "State" should be interpreted in a broad sense, including not only State bodies but also regional and local authorities.

The aid can also be granted through public funds administrated by non-State bodies if they play a role of intermediary for the State authorities or if the aid is granted through a fund under State aid control. Measures financed by compulsory contributions can raise more difficulties. On this issue, one of the most interesting questions is related to the transfer of State resources.

Again, the *PreussenElektra* case brings some light on the question. Indeed, the Court considered that no direct or indirect transfer exists despite the fact that the purchase obligations are imposed by statute and confer an undeniable advantage to certain undertakings: *"A statutory provision of a Member State which, first requires private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity and second, distributes the financial burden resulting from that obligation between those electricity supply undertakings and upstream private electricity network operators, does not constitute State aid"*.[35]

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30 Then, the term "or" should be interpreted as "and". For a clear example, *see* Case C-189/91, *Petra Kirsammer-Hack v. Nurhan Sidal*, Judgment of 30 November 1993, ECLI:EU:C:1993:907, paras. 16-19.

31 Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001, ECLI:EU:C:2001:160, para. 58.

32 Case C-379/98, supra note 31, para. 60.

33 Case T-251/11, *Republic of Austria v. European Commission*, Judgment of the General Court of 11 December 2014, ECLI:EU:T:2014:1060, para. 59.

34 Case C-272/12P, *European Commission v. Ireland and others*, Judgment of 10 December 2013, ECLI:EU:C:2013:812, para. 93.

35 Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001, ECLI:EU:C:2001:160, para. 66 related to para. 61.

b) The criterion of advantage

Advantage is a substantial element and a broad notion that covers a very large range of situations. The advantage can be temporary, either direct or indirect (*"in any form whatsoever"*). Therefore, the fact that an advantage is labelled as a tax, a parafiscal levy, a charge or a duty, does not prevent the Commission (nor at times the CJEU) from carrying out a deep research into the economic consequences of a specific government regulation in order to establish whether certain elements of the regulation constitute unlawful State aid or not.

As it was clarified by the CJEU, a link between the notions of "advantage" and "State originated resources" should also be considered. In the case *Compagnie Commercial de l´Ouest,* a French parafiscal charge levied on certain petroleum products under the same conditions for both domestic and imported products was put into question, because the incomes generated were used only for the benefit of domestic products[36]. In other words, tax advantage may also derive from the use of tax resources. Despite the difficulties in identifying the tax advantage, the Commission distinguished, in its 1998 Notice, three main categories of tax advantages that may be provided through a reduction in the firm´s tax burden: a reduction in the tax base (such as special deductions, special or accelerated depreciation arrangements or the entering of reserves on the balance sheet); a total or partial reduction in the amount of tax (such as exemption or a tax credit); and the deferment, cancellation or even special rescheduling of tax debt.[37] Moreover, the Commission defined the advantage by reference to a measure, which confers *"on recipients an advantage which relieves them of charges that are normally borne from their budget"*.[38] In the analysis made by the Commission and the CJEU in the EU practice, the notion of "advantage" is not always separated from the concept of "selectivity" when the assessment concerns tax measures. Indeed, both notions require a departure from the standard application of the general system.[39]

We agree with some authors who have criticised the absence of distinct and separate approaches to the concept of an "advantage" on the one hand and "tax selectivity" on the other. In this sense, it has been argued that this simplistic approach to check selectivity and advantage *de facto* negates Member States a full assessment of all elements of the State aid prohibition. The root of the problem lies on the CJEU´s approach to the "system immanence test". Certainly, from the time of the judgment in *Adria-Wien Pipeline*, in 2001, the CJEU has treated system immanence as part of the selectivity element.[40]

c) Selectivity of the aid

Only the measures granting an advantage in a selective way to certain undertakings or categories of undertakings or to certain economic sectors fall under the notion of aid. Thus, general measures, which are effectively open to all undertakings operating within a Member State on an equal basis, are not selective. Nevertheless, for a measure to be genuinely general in character, it shall not be *de facto* reduced in scope by factors that restrict its practical effect.

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36 *See* Joint cases C-78/90, C-79/90, C-80/90, C-81/90, C-82/90 and C-83/90, *Compagnie Commerciale de l´Ouest and others v. Receveur Principal des Douanes de La Pallice Port,* Judgment of 11 March 1992, ECLI:EU:C:1992:118, paras. 31-35.

37 European Commission (1998), Notice on the application of the State aid rules to measures relating to direct business taxation (OJ C, 384, 10.12.1998), at para. 9.

38 European Commission Notice (1998), supra note 37, at para. 9.

39 The two criteria have been analysed under the same aspect of "selective advantage". *See* European Commission Notice (1998), supra note 37, at para. 9.

40 *See* Thomas Jaeger, From Santander to LuxLeaks – and Back. EStAL 14(3): 345-357, 550-551 (2015).

Nicolaides, in assessing the applicability of article 107 (1) TFEU to tax measures, argues as follows:

> "there is normally no doubt that they involve transfers of public funds[41] (because, for example, tax reductions result in loss of tax revenue), that they confer an advantage (because they reduce liabilities that are normally covered by the revenue of the beneficiary undertakings) and that they affect trade and distort competition (because the concept of trade is very wide and once trade is affected it is very easy to show that some firms in other Member States are harmed by the extra competition from lower taxes). Therefore, the core issue in most cases is whether a tax measure is selective or not; i.e. whether it relieves from taxes only certain undertakings instead of all undertakings that are normally liable to that tax. Since, however, tax systems are not uniform (i.e. they apply different rates of taxation to different sources of income) and since they apply to so many diverse activities, it is not easy to determine whether a tax measure is selective".[42]

d) Affectation of trade, distortion of competition and adverse effects

These are distinct and necessary elements of the notion of aid. In practice, however, these criteria are often treated jointly in the assessment of State aid as they are, as a rule, considered inextricably linked. The Court case-law does not require an actual analysis of these criteria and has developed an extensive interpretation of the conditions of affectation of trade and competition.

In fact, for practical purposes, a distortion of competition within the meaning of Article 107 TFEU is generally found to exist when the State grants a financial advantage to an undertaking in a liberalised sector where there is, or could be, competition.[43] The Commission has developed a set of rules applicable to the so-called "de Minimis' aid" and according to the new 2013 de *Minimis* regulation[44], aids no more than EUR 200,000 granted over a period of the three years fall outside the scope of the State aid law.

2.3. Some landmark cases on energy taxes

It is remarkable that several landmark cases in the area of taxation, like *PreussenElektra*[45]*, Adria Wien-Pipeline*[46]*, British Aggregates*[47]*, Transportes Jordi Besora*[48] and *Kernkraftwerke Lippe-Ems GmbH*[49], or recent

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41 Parafiscal levies and analogous subsidy schemes are analysed by the European Court on a case by case basis. In *Austria v. Commission*, case T-251/11, the Court finds that the partial exemption of energy intensive consumers included within the Austrian Green Electricity Act 2008 is a State aid, using State resources. Case T-251/11, *Republic of Austria v. European Commission*, ECLI: EU:T:2014:1060. In the *Preussen Electra* case (a landmark decision), the Court considered that the obligation to buy renewable electricity imposed to electricity suppliers by German legislation, does not involve any transfer of State resources to undertakings, which produce green electricity and ruled: "Statutory provisions of a Member State which, first, require private electricity supply undertakings to purchase electricity produced in their area of supply from renewable energy sources at minimum prices higher than the real economic value of that type of electricity, and second, distribute the financial burden resulting from that obligation between those electricity supply undertakings and upstream private electricity network operators do not constitute State aid within the meaning of Article 92(1) of the EC Treaty". Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001, ECLI:EU:C:2001:160. In *Association Vent De Colère! et al v. Ministre de l´Ecologie, du Développement durable, des Transports et du Logement and Ministre de l´Economie, del Finances et de l´Industrie*, C-262/12, ECLI:EU:C:2013:2013:851, the Court concluded that the obligation to purchase wind-generated electricity at a price higher than the market price that is financed by all final consumers of electricity in the national territory, constitutes an intervention through State resources.

42 Phedon Nicolaides, Fiscal State Aid in the EU: The limits of tax autonomy. World Competition 27(3), 365-396 (2004).

43 European Commission (2016), Commission Notice on the notion of State aid as referred to in Article 107(1) TFEU, at para. 187 and Judgment of the General Court of 15 June 2000, *Atzetta*, Joined Cases T-298/97, T-312/97 etc., ECLI:EU:T:2000:151, para.80.

44 European Commission (2013) Commission Regulation No. 1407/2013 of 18 December 2013 (OJ L 352/1, 24.12.2013).

45 Case C-379/98, *PreussenElektra v. Schleswag*, Judgment of 13 March 2001, ECLI:EU:C:2001:160, *see* para. 58.

46 Case C-143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirection für Kärnten*, Judgment of 8 November 2001, ECLI:EU:C:2001:598, *see* paras. 52-55.

47 Case C-487/06 P, *British Aggregates Association v Commission of The European Communities and United Kingdom*, ECLI:EU:C:2008:757, *see* paras. 85 and 89.

48 Case C-82/12, *Transportes Jordi Besora SL v Generalitat de Catalunya*, Judgment of 27 February 2014 ECLI:EU:C:2014:108, *see* paras. 32-36.

49 Case C-5/14, *Kernkraftwerke Lippe-Ems GmbH v. Hauptzollamt Osnabrück*, Judgment of 4 June 2015, ECLI: EU:C:2015:354, *see* paras. 48-54 and 79.

cases like *Republic of Austria v. European Commission*[50], dealt with energy taxes or levies. These cases represent a significant step towards the clarification of the notion of State aid and its compatibility with the internal market. However, since a few years ago, new trends may increase the problems due to the effects-based approach, according to which only the effect of the measure on the undertaking is relevant, and not the cause or the objective of the State intervention.[51]

According to settled case-law, in the absence of harmonization of particular tax provisions, Member States are not prohibited from granting tax advantages in the form of exemptions or reduced rates, applicable to certain products or undertakings. Indeed, tax advantages of this kind may serve legitimate economic, environmental and social purposes[52] and differential treatment of economic activities may be always justified by reference to their respective statutory and regulatory conditions.[53]

However, under EU State aid law, the objectives of the measure are not taken into account and it is common ground that the tax measure is examined only in the light of its effects which prevail over its objectives. The CJEU has constantly maintained that article 107 (1) TFEU defined aids in relation to their effects and neither economic, nor fiscal nor environmental objectives can be taken into account for the appraisal of State aid. If there is one question that could be raised, it is whether the objective pursued by the tax measure could be taken into account. In that regard, it should be noted that what is commonly known as the `three-step analysis´ cannot be applied in certain cases to analyse material selectivity, taking into account only the practical effects of the measures concerned. This means that in some exceptional circumstances, to apply State aids rules, it is also necessary to evaluate whether the boundaries of the system of reference have been designed in a consistent manner (is the levy itself the right reference system as it was stated in *Adria-Wien Pipeline*[54]) or, on the contrary, in a clearly arbitrary or biased way, so as to favour certain undertakings which are in a comparable situation with regard to the underlying logic of the system in question.[55]

Although acceding to CJEU case-law that only the effect of the measure on the undertaking is relevant and not the cause or the objective of the State intervention,[56] in *Adria-Wien Pipeline*, the ecological considerations underlying the national legislations at issue were relevant and *"do not justify treating the consumption of natural gas or electricity by undertakings supplying services differently than the consumption of such energy by undertakings manufacturing goods"* because *"energy consumption by each of those sectors would be equally damaging to the environment"*.[57] Similarly, in the *British Aggregates* case, the Court ruled that *"it is appropriate to examine whether within the context of a particular legal system that measure constitutes an advantage for certain undertakings in comparison with others which are in a comparable legal and factual situation"*.[58] In

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50 Case T-251/11, *Republic of Austria v. European Commisssion*, ECLI:EU:T:2014:1060, *see* paras. 160-171.

51 *See* case C-173/73, *Italy v Commission of the European Communities*, Judgment of the Court of 2 July 1974, para. 13, ECLI:EU:C:1974:71, and C-487/06 P, *British Aggregates v Commission* (supra note 47), paras. 85 and 89. The effects-based approach contribute towards the policy goal of "less and better targeted aid" and is helpful in terms of increasing the effectiveness and predictability of state aid control. See Fiederiszick, H.W., *et al., European State Aid Control: economic framework*, MIT Press, 2006, 2, 54.

52 Case C-148/77, *Hansen jun. & O.C. Balle GmbH & Co. v Hauptzollamt Flensburg*, Judgment of 10 October 1978 ECLI:EU:C:1978:173, para. 16.

53 Case C-353/95P, *Tiercé Ladbroke SA v Commission*, Judgment of 9 December 1997, ECLI:EU:C:1997:596, para. 35.

54 The advantageous terms granted in this case to undertakings manufacturing goods were intended to preserve the competitiveness of the manufacturing sector within the EU. Then, providing an energy taxes rebate for an entire sector of the economy, such as the manufacturing sector, would be regarded as entailing a State aid. See Case *Adria-Wien Pipeline GmbH* (*see* supra note 46), paras. 52-55.

55 *See* on that regard, the European Commisssion Notice (2016), supra note 43, at para.129 and case-law references.

56 *See* case C-173/73 (supra note 51), para. 13, and C-487/06 P, *British Aggregates Association v Commission of the European Communities* (supra note 47), paras. 85 and 89.

57 *See* supra note 46, para. 52. The advantageous terms granted in this case to undertakings manufacturing goods were intended to preserve the competitiveness of the manufacturing sector within the EU. Conversely, in *Stadtwerke Schwäbisch Hall GmbH v Commission*, the CJEU held that the treatment of tax reserves for the decommissioning of nuclear power stations and the safe disposal of nuclear waste in Germany did not constitute State aid since it was based on generally applicable provisions allowing for the creation of reserves by all undertakings satisfying the relevant criteria (*see* Case T-92/02, Judgment of 26 January 2006, ECLI: EU:T:2006:26, para.93).

58 *See* supra note 47, para. 82.

some cases the Court refers to the objectives pursued by the "system" in question while in other cases it mentions the objectives pursued by the "measure" in question. As has been observed, this can bring about different outcomes.[59]

Regarding the features to an "energy tax" (although based on the harmonizing Directive of hydrocarbon taxes), the EUCJ held that the concept must be related to its legal setup for its admission as "environmental tax", especially in the case *Transportes Jordi Besora*. Since every tax necessarily pursues a budgetary purpose, the mere fact that a tax is intended to achieve a budgetary objective cannot, in itself, suffice to preclude that tax from being regarded as having, in addition, a `specific purpose´ within the meaning of article 3(2) of Directive 92/12. According to the CJEU *"a tax such as the IVMDH could be regarded as being itself directed at protecting the environment (…) only if it were designed, so far as concerns its structure, and particularly the taxable item or the rate of tax, in such a way as to dissuade taxpayers from using mineral oils or to encourage the use of other products that are less harmful to the environment"*.[60]

In the Lippe-Ems case, regarding the German nuclear fuel tax[61], the ECJ clarified that article 14(1)(a) ETD is to be interpreted *"as not precluding national legislation which levies a duty on the use of nuclear fuel for the commercial production of electricity"*, first because the nuclear fuel that is the subject of the German Law (*KernbrStG*) does not constitute an energy product' for the purposes of the ETD and it is not, therefore, covered by the exemption laid down in this article of that Directive, and secondly, because it cannot be applied by analogy to the nuclear fuel that is the subject of *KernbrStG*.[62] This case is also interesting because of the selectivity criteria analysis held by the Court which may be seen in this statement: *"methods of producing electricity, other than based on nuclear fuel, are not affected by the rules introduced by KernbrStG and that in any event, they are not, in the light of the objective pursued by those rules, in a factual and legal situation that is comparable to that of the production method based in nuclear fuel, as only that method generates radioactive waste arising from the use of such fuel"*.[63]

Finally, most of interesting issues on State aids and energy taxation are extensively considered in the case T-251/11, concerning parafiscal levies in the Austrian Green Electricity Act.[64] The CJEU held that while extra cost or additional cost is comparable to a special tax levied on electricity, the rules governing reductions of energy taxes under the law of the Union cannot be applied to para-fiscal charges by analogy.[65] It is important to highlight that the Court stated, in this case, that the whole Austrian scheme is a State aid incompatible with the internal market, against the Community guidelines on State aid for environmental protection. The Court stressed that the exemption does not reflect harmonisation at EU level regarding taxation in the area of renewable energy.

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59 *See* Claire Micheau, State Aid, Subsidy and Tax Incentives under EU and WTO Law, Wolters Kluwer 287 (2014).

60 *See* supra note 48, para. 32.

61 *See* supra note 49.

62 *See* paras. 47-48 and 53 of the referred Judgment (supra note 49).

63 *See* para. 79 of the referred Judgment (supra note 49).

64 *See* Marta Villar Ezcurra, supra note 29.

65 *See* para. 68 and 169 of the referred Judgment and case-law referred on these paragraphs.

3. The World Trade Organization´s rules on subsidies

The World Trade Organization (WTO) is the only global organization dealing with the rules of trade between nations. Established in 1995 as the successor to the 1947 General Agreement on Tariffs and Trade (GATT), the WTO has a global membership of 162 countries since 30 November 2015 representing 92 per cent of the world's population and 95 per cent of world-wide trade. WTO is a government-driven organization that acts as a dispute settlement forum for a Member State to initiate a complaint against another Member State. WTO agreements negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments, aim to help producers of goods and services, exporters, and importers conduct their business. Today, the WTO has a limited capacity for coordinating policy on environmental issues, as it faces the all-important problem of achieving international consensus.

The Agreement on Subsidies and Countervailing measures (SCM Agreement) defines a subsidy as a `financial contribution by a government' that confers a benefit´.[66] A `financial contribution' includes tax incentives whereby ´government revenue that is otherwise due is foregone or not collected´.[67] The SCM Agreement provided rules for three types of subsidy: prohibited, actionable and non-actionable.[68] The non-actionable category has existed for five years, ending on 31 December 1999, and was not extended. A subsidy is categorized as prohibited if it is found to be an export subsidy, or an import-substitution subsidy.[69] A country can use the WTO's dispute settlement procedure to seek the withdrawal of the subsidy or the removal of its adverse effects. The disciplines set out in the Agreement only apply to specific subsidies.

3.1. Dispute settlement under the WTO

Several WTO dispute-settlement procedures to seek the withdrawal of the subsidy or the removal of its adverse effects are related to the energy sector.[70] The WTO has been actively involved in a wide range of subsidy disputes. For example, between 1995 and June 2006, there have been 349 requests for consultations; some 35 of these complaints have involved taxation issues.[71] To provide an insight into the dispute resolution and enforcement powers of the WTO and into the notion of `subsidy´ we can refer to the following case.

On 13 September 2010,[72] Japan requested consultations with Canada regarding Canada's measures relating to domestic content requirements in the feed-in tariff program (the ´FIT Program´) affecting the Renewable

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66 Article 1:1, SCM Agreement.

67 Ibid.

68 In an overview, it can be said, in accordance with article 3 of the Agreement on Subsidies, prohibited subsidies are those which enhance the performance of exports, as well grant priority to local content. In this way, the Agreement provides an explanatory – but not exhaustive - list of the first. Conceptually speaking, affect international trade directly and, therefore, tend to restrict a playing field level. On the other side, "actionable" subsidies are less severe and tend to distort but not eliminate competition. In order to be characterized it must be injury a domestic product and create an impairment situation that could lead to a better position to the beneficiary in detriment of a fair competition.

69 Article 3, SCM Agreement.

70 *See* i.e. Dispute Settlements (DS), 412, 419, 426, 449, 473 on the website: https://www.wto.org/english/tratop_e/dispu_e/dispu_subjects_index_e.htm#selected_subject.

71 The effects of Global and Regional Trade Agreements on Domestic Tax Law and Bilateral Tax Conventions: Proceeding of a Seminar held at the 60th International Fiscal Association Congress, Intertax Vo. 35, Issue 4, 292 (2007).

72 *See* DS412. The Panel majority dismissed Japan's allegations on the grounds that Japan had failed to establish the existence of a subsidy. Among the Panel majority's key findings in support of this assessment was that the Hourly Ontario Electricity Price ("HOEP") that was at the center of Japan's main benefit arguments could not serve as an appropriate benchmark against which to determine whether the challenged measures conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

Energy Generation Sector. Japan alleged, among other reasons, that it appears that a subsidy is granted under the measures because there would be a financial contribution or a form of income or price support, and a benefit is thereby conferred. It is also claimed that the subsidy would be a prohibited subsidy under Articles 3.1(b) and 3.2 of the SCM Agreement because it appears to be provided "contingent … upon the use of domestic over imported goods", namely contingent upon the use of equipment for renewable energy generation facilities produced in Ontario over such equipment imported from countries such as Japan.

3.2. Comparing WTO´s and EU´s rules on aids and subsidies

A fair trade approach has traditionally prevailed in both the administration of EU State aid and WTO subsidy laws but for different reasons.[73] In the EU, the blunter internal market approach, which presumed that any State aid was distorting competition and trade, was instrumental to liberating and protecting the economic forces of an increasingly enlarged internal market while avoiding unfair competition between Member States. In the WTO context, the construction of the relevant `injury' standards, intends to create a more flexible scenario in order to challenge subsidies. Following Luca Rubini, we can nowadays say that there is a shift from a `trade´ to a `competition´ perspective. This means that the system moves to focus to measures that intrinsically distort competition than merely inhibit international trade. Both are laws about competition.[74]

The major distinction settles on definition and scope of a trade legal system. The EU rules on State aid are subject to a number of exceptions based on policy objectives, which are similar to the SCM Agreement´s now-expired rules on non-actionable subsidies. In contrast to the SCM Agreement, the EU State aids rules apply to both trade in goods and trade in services.[75] Considering that tax incentives are a subsidy category, in accordance with SCM Annex, in principle, in WTO law governments are free to impose any environmentally motivated taxes on products, as long as they do not discriminate against imported products. Even if a tax is discriminatory, there are some exceptions that may be invoked to justify this discriminatory treatment, including environmental purposes under Article XX.[76] In the EU law, the European Court of Justice developed the exceptions justifying fiscal aids being the environmental protection a legitimate interest.[77]

Hence, EU State aid law and WTO subsidy law are two different sets of regulations which have differences in their scope, definition and application. Both regimes seek to regulate state interventions and adopt a broad interpretation of the criterion of "State-originated measure" but even if the appreciation of `charge of the public account´ differs, this does not lead to divergent assessment regarding tax incentives. In both regimes, the interpretations of the notions of EU `advantage´ and WTO `benefit´ remain similarly based on a comparison of tax treatments between the one under review and the one generally applicable. Regarding the assessment of tax selectivity under EU law, the CJEU´s case-law held that a tax measure can be justified by the nature and general scheme of the system (including environmental aims). Conversely, according to Article 2 of the SCM Agreement[78], there is a presumption of selectivity for prohibited subsidies[79]. However, in tax

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73 For a complete analysis of on the topic *see* Claire Micheau, supra note 59.

74 *See* Luca Rubini, The definition of Subsidy and State Aid. WTO and EC Law in Comparative Perspective, Oxford University Press 422-423 (2009).

75 The SCM Agreement does not apply to trade in services. Subsidies on trade in services come within the GATS but the rules have not been developed so far. A good example of a tax measure which applies in the two sectors is *Adria-Wien Pipeline* case (*see* supra note 46).

76 *See* Ingrid Jegou and Luca Rubini, The Allocation of Emission Allowances Free of Charge: Legal and Economic Considerations, ICTSD Programme on Competitiveness and Sustainable Development, August/2011, Issue Paper No. 18 (2011). See also: http://worldtradelaw.typepad.com/ielpblog/2012/05/gatt-article-xx-as-an-exception-to-the-scm-agreement.html.

77 *See* Birgitte Egelund Olsen, Gaining intergovernmental acceptance: legal rules protecting trade in Handbook of research on environmental taxation, 202 (2012).

78 A subsidy should be specific "to an enterprise or industry or group of enterprises or industries".

79 The notion of specificity is defined in such way that it covers measures which are specific de jure as well as the facto. For a thorough analysis of tax selectivity *see* Claire Micheau, supra note 59.

matters the key issue in WTO law is whether it constitutes `foregoing of revenue otherwise due´ and WTO case-law provides a comparison of two different tax treatments. Apart from that, under EU law a selective tax measure can be justified but the justification does not exist under WTO law.

4. The United States Commerce Clause and State Energy Tax Expenditures

This part explores the extent to which the US constitution limits the ability of states within the union to use energy-related tax expenditures, focusing on the clause in the constitution that gives the federal government the power to regulate interstate commerce. It briefly compares the American approach with the EU's State aid rules. It provides an overview of the "dormant commerce clause" in the federal constitution—the provision in the constitution that is most directly relevant—and how the dormant commerce clause applies to state-level tax measures. It then explores how the commerce clause may limit states' use of green energy tax expenditures and how those limits compare to the EU's State aid rules. It concentrates on the state level of government because US states are comparable to EU Member States when one is considering how the law addresses the issue of regulating internal markets. When thinking about the role of tax policy in the energy and climate change context, however, it is important to remember in the background that the US federal government has extensive and relatively uninhibited powers of taxation that can allow it also to directly employ tax instruments to achieve environmental goals—unlike the EU at the Union level which has constrained powers of taxation.[80]

4.1. The Federal Constitution's Dormant Commerce Clause

The US constitution binds together the fifty US states and forms the political and legal map for governance. It defines the relative power of the states and the federal government and hence is the focal point of the discussion below about the degree to which states have the freedom to pursue energy-related tax expenditures.

One of the architectural principles of the United States is that the states should function together as a common market with the federal government holding the power to regulate interstate commerce.[81] The federal constitution captures this principle in what is known as the commerce clause, which provides that "The Congress shall have Power To … regulate Commerce with foreign Powers, and among the several States".[82] Under the constitution, the states retain residual power not delegated to the federal government,[83] leaving states with their inherent police powers.

Although the commerce clause expressly gives Congress regulatory power over interstate commerce, the United States Supreme Court has long held that the commerce clause also operates as an implicit limit on states' power, restraining them from using their authority in ways that will interfere with interstate commerce.[84] "This antidiscrimination principle 'follows inexorably from the basic purpose of the Clause' to

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80 For an overview of how the federal government has used federal tax expenditures to address climate change, *see* Janet E. Milne (2016 supra note 10).

81 In the view of an early Justice of the US Supreme Court, the need to keep trade among the individual states free from restraints was the "immediate cause" for calling a constitutional convention. Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine, 520 U.S. 564, 571 (1997) (quoting Justice Johnson's concurring opinion in Gibbons v. Ogden, 9 Wheat 1, 224 (1824)).

82 U.S. Constitution, art. 1, §8, clause 3.

83 "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U. S. Constitution, amendment 10.

84 See, e.g., Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine, 520 U.S. 564, 571-72 (1997).

prohibit the multiplication of preferential trade areas destructive to the free commerce anticipated by the Constitution."[85] This implicit limitation on states is often referred to as the "dormant commerce clause," or "negative commerce clause." It lies in quiet repose under the surface of the explicit constitutional language, but its dormancy should not be interpreted as a lack of force. It can wield significant legal force in guarding the internal market. As the Supreme Court has said, a discriminatory tariff "violates the principle of the unitary market by handicapping out-of-state competitors, thus artificially encouraging in-state production even when the same goods could be produced at lower cost in other States."[86] Hence the dormant commerce clause is central to evaluating how the federal constitution defines the rules governing the regulation of trade across state lines—and the extent to which the constitution limits the states' ability to offer environmentally related tax relief.

The commerce clause consists of only a small handful of words, and under the American legal system, courts are the guardians of its meaning. Courts, not legislative bodies or executive bodies, are the arbiters of the commerce clause, its dormant shadow, and its enforcement, and the United States Supreme Court has the final say when parties take cases to the Supreme Court and it chooses to hear them.[87] This paper looks primarily at the Supreme Court's interpretation of the dormant commerce clause. It also briefly considers how Congress can affirmatively preempt state taxation through its affirmative power under the commerce clause to regulate interstate commerce.

4.2. The Dormant Commerce Clause and State Taxes

Under the Supreme Court's interpretation of the dormant commerce clause, states' taxing powers are subject to the dormant commerce clause.[88] This determination sets up an interesting and still evolving duel between the federal interest in maintaining an open, unrestrained market for interstate trade and states' inherent power to determine how they want to employ their taxing authority—an authority that states use in widely divergent ways depending on their individualized policies governing which tax regimes to employ and how to design them. In the Supreme Court's words:

> We have acknowledged that the delicate balancing of the national interest in free and open trade and a State's interest in exercising its taxing powers requires a case-by-case analysis and that analysis has left " 'much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.' "[89]

The Supreme Court established a four-factor test in *Complete Auto Transit, Inc. v. Brady*[90] to determine when a state tax violates the dormant commerce clause. A state tax will survive scrutiny under the dormant commerce clause if the tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."[91] If the tax discriminates against interstate commerce, it will be deemed invalid under a "virtually

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85 Maryland v. Louisiana, 451 U.S. 725, 754 (1981) (quoting Boston Stock Exchange v. State Tax Commissioner, 429 U.S. 318, 329 (1977)).

86 West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 193 (1994).

87 The Supreme Court has discretion to decide whether to take cases apart from cases of "original jurisdiction", such as Maryland v. Louisiana, 451 U.S. 725 (1981) (dormant commerce clause tax case between two states).

88 See, e.g., Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977).

89 Westinghouse Electric Corp. v. Tully, 466 U.S. 388, 403 (1984) (quoting prior Supreme Court cases). The court has also referred to the states' taxing power as a "primeval governmental activity." New Energy Company of Indiana v. Limbach, 486 U.S. 269, 277 (1988).

90 430 U.S. 274, 279 (1977).

91 Id. at 279.

per se rule" unless the state shows that it serves a "legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives"—a burden "so heavy that 'facial discrimination by itself may be a fatal defect.'"[92] Discrimination can appear on the face of the state or local tax law or in the effect of the tax. Even a de minimus discriminatory effect will trigger scrutiny.[94]

A Supreme Court decision illustrates how a state environmental fee or tax can run afoul of the dormant commerce clause if it treats out-of-state activities differently than in-state activities.[95] The State of Oregon charged a fee of $0.85 cents per ton for disposal of waste generated within the state and an additional fee of $2.25 per ton for the in-state disposal of waste generated in another state.[96] Analyzing the fee as a tax, the Court found that the fee was facially discriminatory against interstate commerce and that the state failed to meet its heavy burden of showing that the fee advanced a legitimate goal that could not be achieved through any reasonable, nondiscriminatory alternative. It determined that the fee on out-of-state waste did not merely compensate for other fees or taxes that applied to in-state waste.[97]

When evaluating whether a tax discriminates against interstate commerce, the Court will consider the combined effect of policy measures, not just the effect of the tax alone. In an important Supreme Court case,[98] the State of Massachusetts required dealers that sold milk to retailers to pay premiums into the Massachusetts Dairy Stabilization Fund based on the volume of milk sold, the vast majority of which was from out-of-state farmers. The State then distributed the Fund's proceeds only to in-state milk producers as cash subsidies. The Court found that the payments were effectively a tax, and although the tax applied equally to sales of milk produced in state and out of state, the subsidy paid to the in-state producers meant that only out-of-state milk bore the real economic burden.[99] It explicitly refused to analyze the payments and the subsidy independently.[100] It also rejected the argument that the need to protect the in-state dairy industry justified the tax.[101]

Thus, as these cases illustrate, the dormant commerce clause can restrain states from using their taxing authority in ways that will discriminate in favor on in-state activities.

4.3. The Dormant Commerce Clause and State Tax Expenditures

The dormant commerce clause applies not only to taxes but also to tax expenditures within state and local tax regimes.[102] As a result, it is concerned not only with the way in which sub-national governments might use their tax powers to place costs on interstate commerce but also how they may offer tax benefits than can discriminate against interstate commerce—an aspect of the dormant commerce clause that is directly relevant to comparisons with the EU's State aid rules. The Supreme Court has considered how the dormant commerce

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92 Oregon Waste Systems, Inc. v. Department of Environmental Quality of the State of Oregon, 511 U.S. 93, 100-101 (1994) (citing prior Supreme Court cases). Hence courts do not apply a "balancing test" that could uphold nondiscriminatory regulations that impose incidental impacts on interstate commerce if the burden is not excessive relative to the local benefits. *See* id. at 99, 101 (rejecting the balancing test used in Pike v. Bruce Church, Inc., 397 U.S. 137 (1970), because the surcharge was discriminatory).

93 Walter Hellerstein, Sate Taxation Part III, Chapter 4, ¶¶ 4.14[1][a], [b] (3rd ed. 2014). See, e.g., Bacchus Imports, Ltd. V. Dias, 468 U.S. 263, 270 (1984).

94 Id. at ¶ 4.14[1][d] (3rd ed. 2014).

95 Oregon Waste Systems, Inc. v. Department of Environmental Quality of the State of Oregon, 511 U.S. 93 (1994).

96 Id. at 97.

97 Id. at 99-107.

98 West Lynn Creamer, Inc. v. Healy, 512 U.S. 186 (1994).

99 Id. at 195-96.

100 Id. at 198-202.

101 Id. at 204-205.

102 *See generally* Walter Hellerstein, Commerce Clause Restraints on State Tax Incentives, 82 Minnesota Law Review 413 (1997).

clause applies to an array of tax expenditure measures that subsidize activities, evaluating when they improperly discriminate against interstate commerce.[103]

Tax expenditures can take the form of lower tax rates for preferred activities. The case involving the Oregon fee on waste disposal, described above, could be characterized as a case about tax expenditures. By using differential rates that favored in-state activities over out-of-state activities, the state was in effect offering aid to in-state activities. However, states may also use other types of tax expenditures to pursue their goals, such as tax exemptions or tax credits and need to be wary of dormant commerce clause limitations.

For example, when the state of Hawaii exempted certain locally produced alcoholic beverages from its 20% excise tax on wholesalers' sales of liquor in order to encourage in-state industry, the Supreme Court found that the exemption violated the dormant commerce clause.[104] The Court recognized but did not defer to the state interest. "No one disputes that a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry. However, the Commerce Clause stands as a limitation on the means by which a State can constitutionally seek to achieve that goal. One of the fundamental purposes of the Clause 'was to insure … against discriminating State legislation.'"[105]

Similarly, state tax expenditures in the form of tax credits have fallen prey to the dormant commerce clause's limitations, as illustrated by a Supreme Court case that involved an alternative energy tax provision. The State of Ohio offered fuel dealers a tax credit for each gallon of ethanol they sold in gasohol. The dealers could use the tax credit to offset their liability for the state's tax on sales of motor vehicle fuel.[106] However, the tax credit applied only to sales of ethanol produced in Ohio or in a state that provided a reciprocal benefit for ethanol produced in Ohio.[107] The Court held that the tax credit discriminated against interstate commerce.[108] The State argued that the tax credit was nonetheless justified because it would reduce harmful emissions from vehicles by stimulating the market for ethanol production in Ohio and by encouraging other states to enact similar credits to would encourage ethanol production. Rejecting this argument, the Court reasoned that ethanol produced in other states was no less healthy than ethanol produced in Ohio or states with comparable tax credits. "It could not be clearer that health is not the purpose of the provision, but is merely an occasional and accidental effect of achieving what is its purpose, favorable tax treatment for *Ohio*-produced ethanol."[109] Thus, a tax credit that arguably pursued environmental policy goals but favored local activity over interstate commerce violated the dormant commerce clause.

If a state tax expenditure is part of a multifaceted set of interrelated policies, courts will look at the entire tax scheme to determine whether there is a net discriminatory effect. A case involving Louisiana's taxes on natural gas illustrates this approach (consistent with the Massachusetts dairy case described above). The State of Louisiana taxed natural gas entering the state primarily from the Outer Continental Shelf. The tax was equal to the amount of the severance tax that applied to gas produced within the state and reportedly was designed

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103 The Supreme Court cases that analyze tax expenditures tend to focus on whether the tax measure is discriminatory. The *Complete Auto* test for taxes, described above, contains four factors of which discrimination against interstate commerce is one factor. The focus on the discrimination prong is logical, because tax expenditures do not raise the same issues of nexus to the state and apportionment (issues more relevant a tax than a tax expenditure) and relationship to the use of the revenue (not relevant because revenue is only lost).

104 Bacchus Imports, Ltd. V. Dias, 468 U.S. 263 (1984).

105 Id. at 271 (quoting Welton v. Missouri, 91 U.S. 275, 280 (1876)).

106 New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 271 (1988).

107 Id. at 271.

108 Id. at 276.

109 Id. at 279 (emphasis in original, footnote omitted). The Court employed similar logic in Chemical Waste Management v. Hunt, 504 U.S. 334 (1992), when it held that a state fee on out-of-state hazardous waste, higher than the fee on in-state waste, discriminated against interstate commerce. It reasoned that the environmental concerns did not depend on the origin of the waste. Id. at 345-46.

to compensate the state for environmental damage to coastal areas.[110] The legislation *inter alia* provided a tax credit for natural gas consumed within the state by certain entities, such as regulated electric utilities, that could be applied against other Louisiana state taxes.[111] The Court found that, as a result, Louisiana consumers of the gas from the Outer Continental Shelf were protected from the tax while consumers of gas that was exported out of the state would bear the burden of the tax, creating a differential tax burden without adequate justification.[112]

As these cases illustrate, state tax expenditures associated with energy or other environmentally related goals can be subject to scrutiny under the dormant commerce clause. This does not mean, however, that no tax expenditures are allowed. The challenge is to determine which measures discriminate against interstate commerce and which do not, which is not always easy. Judicial application of the discrimination principle is conducted on a fact-sensitive, case-by-case basis,[113] which generates rules by precedent rather than comprehensive, bright-line rules.[114]

The task of determining when state tax measures improperly discriminate against interstate commerce is perhaps particularly challenging for tax expenditures. Tax expenditures are embedded in state tax systems, so they inherently are available only to entities active enough in the state to incur state tax liability, and they are designed to encourage specific activities within the state. At what point do these in-state benefits place a burden on interstate commerce? Some tax expenditures may draw explicit distinctions that make it easier to find discrimination, such as the Ohio tax credit available primarily for ethanol produced in state to the disadvantage of out-of-state ethanol (or the exemption for alcohol produced in Hawaii).[115] Ohio's tax credit could have survived it if had applied to all ethanol; it failed constitutional muster because it placed Ohio ethanol in a more privileged position.

In many instances, however, tax expenditures may be facially neutral. The question then is whether offering a benefit through the state tax system to encourage an in-state activity, without explicit discrimination against similarly situated out-of-state activity, will be deemed to place a burden on interstate commerce in violation of the dormant commerce clause. The Supreme Court seemed poised to address this issue when it decided to review a federal Court of Appeals decision, *DaimlerChrysler v. Cuno*.[116] Although the Court ultimately did not reach the merits of the dormant commerce clause issue, the lower court decision illustrates the challenge of drawing the line between the legitimate use of the state tax expenditures within the state police powers and discrimination against interstate commerce in violation of the dormant commerce clause.

In *DaimlerChrysler v. Cuno*, the State of Ohio offered an investment tax credit and a local property tax exemption to DaimlerChrysler when the company agreed to construct a new vehicle-assembly plant in an economically distressed area, pursuing an intrastate policy of economic development. Yet the Court of Appeals held that the investment tax credit against the state franchise tax (a form of business income tax) discriminated against interstate commerce. It seemed to accept the argument that the tax credit had a coercive effect that interfered with interstate commerce: The tax credit encouraged entities subject to the Ohio

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110 Maryland v. Louisiana, 451 U.S. 725, 731-32 (1981).

111 Id. at 733. The case also involved exemptions and a tax credit against the state severance tax.

112 Id. at 757-59.

113 See, e.g., West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 201 (1994).

114 In addition, Supreme Court Justices can have differing views of the scope of the dormant commerce clause. For example, four Justices dissented in Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine (1997) (Chief Justice Rehnquist and Justices Scalia, Thomas and Ginsburg).

115 For a discussion of how Supreme Court cases about tax incentives have tended to involve overt discrimination, *see* Walter Hellerstein, Commerce Clause Restraints on State Tax Incentives, 82 Minnesota Law Review 413 (1997).

116 Cuno v. DaimlerChrysler, Inc. 386 F.3d 738 (6th Cir. 2004), *vacated in part, remanded in part*, 547 U.S. 332 (2006).

franchise tax to invest in Ohio rather than elsewhere.[117] The court declined to view the tax credit as a benefit to the local economy rather than a burden to interstate commerce,[118] thus rejecting a rationale that could be broadly applicable to tax expenditures that reward in-state activities on a facially neutral basis. However, it also held that the property tax exemption did not violate the dormant commerce clause. It found that, unlike the tax credit against the franchise tax, the property tax exemption did not reduce a preexisting tax liability and therefore was less coercive, and that the "collateral" conditions for qualification relating to the use of the property did not impose burdens on interstate commerce.[119]

The Supreme Court in *DaimlerChrysler v. Cuno* never decided whether the lower court reached the right result on the investment tax credit because it concluded that the plaintiffs in the case, general taxpayers, did not have standing to bring the suit. The fact that the tax expenditures depleted government funds did not constitute injury sufficient to warrant standing to sue.[120] If the Supreme Court had reached the merits, its decision would have helped clarify the application of the dormant commerce clause to tax expenditures.

The discussion above focuses on aid that takes the form of tax expenditures. However, for purposes of comparative analysis, it is very important to note that the Supreme Court has not yet subjected direct expenditure subsidies, such as cash grants or rebates, to scrutiny under the dormant commerce clause even though direct expenditures can be functionally equivalent to tax expenditures from an economic perspective.[121] Some question the legitimacy of this disparate treatment for constitutional purposes,[122] and the Supreme Court may have left a narrow door open for considering the issue in the future.[123] Under current law, however, it appears that a state can chose to dispense benefits in the form of direct payments rather than tax expenditures if it is concerned about dormant commerce clause issues.[124]

4.4. Implications for State Energy Tax Expenditures

Given both the somewhat unsettled parameters of the dormant commerce clause and the wide variety of ways in which tax expenditures can operate, this paper cannot provide a comprehensive or bullet-proof analysis of the implications of the dormant commerce clause for the states' use of energy tax incentives. It instead offers examples to illustrate the types of measures that do and do not appear to be susceptible to challenge under the dormant commerce clause in light of current precedent.

Some states may choose to encourage residential or business consumers to purchase products that carry lower carbon footprints, such as by offering sales tax exemptions or reduced sales tax rates for purchases of products that will increase their on-site use of renewable energy. Even though the products may be sold in interstate commerce, these tax expenditures are not likely to offend the dormant commerce clause unless the

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117 Id. at 743, 745.

118 Id. at 744-46.

119 Id. at 746-47.

120 Cuno v. DaimlerChrysler, Inc. 547 U.S. 332, 345-46 (2006).

121 New Energy Company of Indiana v. Limbach, 486 U.S. 269, 278 (1988). The Supreme Court distinguished tax instruments as being a form of regulation of interstate commerce, unlike direct subsidies. States may also escape dormant commerce clause limitations if they are acting as direct participants in the market. *See*, e.g., id. at 277.

122 *See* Edward A. Zelinsky, Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures?, 112 Harvard Law Review 380 (1998); Edward A. Zelinsky, Cuno: The Property Tax Issue, 4 The Georgetown Journal of Law & Public Policy 119 (2006).

123 *See* West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 199 n. 15 (1994) ("We have never squarely confronted the constitutionality of subsidies, and we need not do so now. We have, however, noted that '[d]irect subsidization of domestic industry does not ordinarily fun afoul' of the negative Commerce Clause" (citation omitted)).

124 Note, however, that a court can still consider a subsidy in the context of the broader tax regime as in West Lynn Creamery, Inc. v. Healy.

state requires that the products must have been manufactured within the state. Like the case involving Hawaiian alcohol, a domestic-product requirement that favors local production would appear to operate in a protectionist manner to the disadvantage of competing products that could be sold in the state as part of the stream of interstate commerce. Similarly, a state or local property tax exemption for renewable energy equipment could be constitutionally acceptable if it is not limited to locally produced products.

These examples stand on relatively strong footing because they do not contain conditions of a discriminatory nature. They also involve state and local sales and property tax regimes under which the beneficiaries of the tax expenditures are not being relieved of a tax burden that already applies to them, making the offer of relief seem arguably less coercive in nature under the *Cuno* line of reasoning.[125]

The same result would occur for sales tax and property tax expenditures for the purchase and use of equipment that produces electricity from renewable sources for sale to third parties, such as a large-scale windfarm. Although the electricity may be sold into the interstate electricity market, and the tax expenditures offer a subsidy that may make the electricity more competitive with electricity produced from fossil fuel, the tax expenditures are not likely to run counter to the dormant commerce clause. The result could different, however, if the tax expenditures apply only to property that produces electricity within the state solely for sale within the state. If the subsidized in-state electricity competes with electricity that enters the state market from other states, the tax expenditures would appear to discriminate against interstate commerce.[126]

Suppose instead that a state offers a tax credit against its income tax for windfarms located within the state equal to "x" cents for each kilowatt hour of electricity produced and sold into the grid, or an investment tax credit for "y" percent of the capital investment incurred in constructing windfarms located in the state. Both forms of tax expenditure would encourage investment in the state by reducing taxpayers' liability under the state income tax. These tax expenditures could be portrayed as being similar to the income tax incentives in *Cuno*. If they would reduce liability for a tax that taxpayers already incur, and if some existing taxpayers would choose not to locate a facility in the state, a court following *Cuno* might conclude that the tax expenditures burden interstate commerce in a discriminatory, coercive fashion.[127]

Finally, a state might offer tax expenditures to relieve its domestic industry from the burden of an energy tax that it thinks will be competitively harmful. For example, suppose a state applies an energy tax to fossil fuels coming into the state but provides relief from the tax through a tax credit or exemption for sales of fuel that will be used for certain purposes within the state. To avoid constitutional controversy, the tax and its tax expenditures should apply equally to in-state and out-of-state fuel. A court would also look closely at the entire tax regime to determine whether embedded tax benefits create unequal treatment, as it did in the Louisiana tax on natural gas described above. Although US states have not yet enacted carbon taxes, this type of tax expenditure has been used in conjunction with some European carbon taxes to provide relief for energy-intensive industries that face competition.

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125 *See* Walter Hellerstein, Commerce Clause Restraints on State Tax Incentives, 82 Minnesota Law Review 413, 438-445 (1997) (also noting constitutional risk of attaching conditions not related to the use of the property). As some have noted, this line of reasoning can yield a somewhat anomalous result. Tax expenditures for in-state sales and property taxes may be less suspect than tax expenditures in state income tax systems, which could be deemed more coercive under *Cuno*, even though the tax expenditures may have the same economic effect regardless of the tax system through which they are delivered. *See* Peter D. Enrich, Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business, 110 Harvard Law Review, 378, 446-47 (1996).

126 *Cf.* New Energy Co. of Indiana v. Limbach, 486 U.S. 269 (1988) (discrimination in favor of ethanol produced and consumed within the state violated dormant commerce clause).

127 For a parallel example involving an income tax credit for pollution-control equipment, *see* Peter D. Enrich, Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business, 110 Harvard Law Review 337, 450-51 (1996).

If a tax expenditure facially discriminates against interstate commerce, a state government might try to assert the defense that the measure serves a "legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives",[128] although "the standards for such justification are high."[129] The mere weight and value of the legitimate purposes of reducing pollution may not be enough to justify discrimination. As discussed above, when the State of Ohio argued that its tax credit for ethanol produced in Ohio would improve air quality and health in and around Ohio, the Supreme Court acknowledged that the State was pursuing a legitimate goal but found that there was no reason to conclude that ethanol produced in Ohio had greater benefits than ethanol produced elsewhere.[130]

4.5. Federal Statutory Preemption of State Tax Measures

The discussion above has focused on how Congress's constitutional power to regulate interstate commerce implies that states also cannot interfere with interstate commerce.[131] The commerce clause's direct grant of power to Congress, however, also allows Congress to explicitly preempt states' ability to engage in taxation that will burden interstate commerce. Congress on limited occasions has exercised this power, most recently to limit the ability of states to impose taxes on internet access. It has not yet chosen to regulate states' use of energy-related tax expenditures to any significant extent.[132] Thus, in the absence of action by Congress, the dormant commerce clause remains as the federal safeguard against state tax expenditures that discriminate against interstate commerce.

4.6. Conclusion

US states have strong powers to develop their own tax policies, which they may or may not decide to use to advance environmental goals. At the same time, the states operate within a common market, and the federal constitution prevents them from discriminating against interstate commerce, including through the use of their tax powers. Although the precise constitutional boundaries of this constitutional limitation are still somewhat amorphous, the constitution allows states to harness their tax codes in significant ways to achieve environmental protection and to address the challenges of climate change.

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128 Oregon Waste Systems, Inc. v. Department of Environmental Quality of the State of Oregon, 511 U.S. 93, 100-101 (1994) (citing prior Supreme Court cases).

129 New Energy Company of Indiana v. Limbach, 486 U.S. 269, 278 (1988).

130 Id. at 279.

131 *See* generally Walter Hellerstein, Testimony, Hearing on Economic Development and the Dormant Commerce Clause: Lessons of Cuno v. DaimlerChrysler and its Effect on State Taxation Affecting Interstate Commerce, Joint Hearing Before the Subcommittee on the Constitution and the Subcommittee on Commercial and Administrative Law of the Committee on the Judiciary, House of Representatives, 109th Congress, May 24, 2005, at 27-28; Michael T. Fatale, Common Sense: Implicit Constitutional Limitations on Congressional Preemptions of State Tax, 2012 Michigan State Law Review 41 (2012).

132 But *see* 15 U.S.C. §391, 42 U.S.C. § 16491 (cited in Walter Hellerstein's written statement, *Cuno* and Competitiveness: Where to Draw the Line, Hearing Before the Subcommittee of International Trade of the Committee of Finance, U.S. Senate, 109th Congress, March 16, 2006, 98 & n.3, 121-22.

5. The Mercosur and Brazil perspective

5.1. Tax incentives in Mercosur and Brazil: general characteristics and distinctions

In South America, within the scope of the Southern Common Market, either in the Treaty of Asuncion (Mercosur Treaty) or in its complementary regulations, there are no provisions that can actually be held as an specific framework to the control of tax incentives in the same way as the EU State aids regime or even the WTO system of subsidies.

In a broader overview, we see that not only are there no regulations and concept of State aid in the scope of the Southern Common Market, but not one of the four countries of the block – Brazil, Argentina, Uruguay and Paraguay - has in its internal regulations as well – with the exception of Brazil for the granting of tax incentives on the ICMS (equivalent to VAT in Brazil) – a mode of controlling aids/incentives that is indeed entailed to the competition law. This way, the aid control issue remains condensed, generally, into the sphere of legality in the granting of incentive (simply matters of procedure, without any other substantive concept such as the level playing field inspired in the American "dormant commerce clause" system as mentioned before). And even within this context, the concept that we work more with, on a domestic or community scope, is the traditional tax incentive concept which mainly deals with the legality principle but not directly with axiological values.

If from a country-by-country perspective there are no such environment such as in the EU, in terms of the southern cone region such status reflects the institutional fragility of Mercosur composed of Brazil, Argentina, Uruguay and Paraguay and which, currently, has Chile, Bolivia, Peru and Venezuela as associate members.

The absence of more detailed legislation within and outside those countries can be explained by many reasons. Firstly, Brazil – the biggest market in Latin America – has had for a long time a strong resistance to create tax and competition law provisions that can restrict Brazilian legitimacy to regulate its internal market. Brazil is the sole country that has resisted up to now to introduce in its Constitution a provision to delegate competences to Mercosur, except from those referred in the Mercosur Treaty. Unlike other Mercosur countries such as Argentina, Uruguay and Paraguay, the rules and regulations enacted by Mercosur Common Market Group – which would be equivalent, *mutatis mutandis* to the European Commission - do not have immediate applicability in Brazil. Therefore, it can be said in the end that, apart for the very traditional non-discrimination provision inserted in Article 7 of the Mercosur[133], Brazil and other Mercosur members are free to design their legislations in terms of tax incentives or regimes regarding energy State aid. Furthermore, the fact that commodities and undertakings such as oil and gas, mining, power plants and other are quite relevant to those countries enhances a non-uniform approach to state tax aid provisions in relations to those industries.

[133] Mercosur Treaty, Article 7: "In the area of taxes, charges and other internal duties, products originating in the territory of one State Party shall enjoy, in the other States Parties, the same treatment as domestically produced products. Article 8. "The States Parties undertake to abide by commitments made prior to the date of signing of this Treaty, including agreements signed in the framework of the Latin American Integration Association (ALADI), and to co-ordinate their positions in any external trade negotiations they may undertake during the transitional period. To that end:(a) They shall avoid affecting the interests of the States Parties in any trade negotiations they may conduct among themselves up to 31 December 1994; (b) They shall avoid affecting the interests of the other States Parties or the aims of the common market in any agreements they may conclude with other countries members of the Latin American Integration Association during the transition period; (c) They shall consult among themselves whenever negotiating comprehensive tariff reduction schemes for the formation of free trade areas with other countries members of the Latin American Integration Association; d) They shall extend automatically to the other States Parties any advantage, favour, exemption, immunity or privilege granted to a product originating in or destined for third countries which are not members of the Latin American Integration Association."

As we have already declared there is nothing in Brazil or in the Southern Common Market, in the text of the Treaty or of the constitutions of the countries, not even coordination (something like the soft European law) with respect to the granting of State aids or incentives. It concerns a more incipient scene than that which existed in histories prior to the formation of rules of the EU law, or in the scope of the WTO, in the period prior to the Uruguay Round when there was no regulation on subsidies substantiated in the ASCM.

On a broader scope, as well as in other Mercosur countries, the limits to the granting of incentives and aids, besides formal criteria (essentially legality), just recently have been censured from a budgetary perspective. The control of granting of public (not only tax) aids is nowadays based on a sanctions act against measures of waiver of public revenues and of maintenance of financial deficit, as it happens in Brazil with the Fiscal Responsibility Law[134]. These regulations came to address the theme from the point of view of internal budget management (list of indebtedness of states-provinces and city before the government), without any concern with respect to the issue of free movement of goods and services in the Southern Common Market or, even, to an economic coordination between Member states of the Southern Common Market on issues such as unification of exchange rate and policies related to interest rates (Central Banks), toward an intensification of the level of integration in the Southern Common Market.

In this entire context, it is important to point out, in relation to other countries, that the constitutions and regulations of Mercosur member countries do not describe important restrictions or mechanisms that can be used to limit public aids which can skew the competition such as concepts of selectivity/specificity, advantage, beneficiary, horizontal aids, etc. With this, the economic right of member countries of the Mercosur is settled just on its private aspect, through laws and institutions against economic abuse in cases of merger, purchase and sale of companies, etc. In the case of Brazil, the Brazilian National Tax Code, or even the Competition Law, neither mentions the concept of State aids from the point of view of competition defense.

The Brazilian Constitution, which is one of the most extensive in the world and which thoroughly sets in detail the Brazilian tax system, does not contemplate something as relevant nowadays as the relation between competition and taxation. In Chapter I, of Title VI of the Brazilian Constitution, which deals with the National Tax System, we see core rules, of rare or no objectivity, which are characterized by absence of regulation of tax provisions that could be related with competition; with the exception of article 146-A, which can be an element of introduction to the concept of State aid in Brazil (although limited to tax aids), as it will be discussed further ahead. Article 146, III, "c", determines an adequate taxation process for the cooperative act and those related to tax exemption in the export of goods and services that do not make any reference to competition-related issues. Article 70 of the Constitution[135], which assumes a budgetary point of view, alludes to the state financial "waiver" policy to restrict it, which would be the closest concept to State aid that can be found in the Brazilian Constitution.

Although a concept of State aid may be missing, for some there would be a natural limitation to its granting when the Brazilian Constitution makes reference to some specific state actions contained in Title VII, Chapter I. That chapter deals with the General Principles of Economic Activity, when delineating the form of operation of the State in the economic order, either as participating agent or as mere regulator, which could be understood as exceptional cases of accepted horizontal measures. In the same chapter we can identify provisions to stimulate renewable energy tax incentives, although in practice cannot constitute a well-defined policy in relation to the subject.

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134 Complementary Law no. 101/2001.

135 Article 70. "The accounting, financial, budgetary, operational and patrimonial control of the Union and of direct and indirect administration entities, with respect to legality, legitimacy, economical nature, application of subsidies and waiver of revenues, will be exercised by the National Congress, through external control, and through the internal control system of each Power".

A good example is the oil and gas tax incentive regime called REPETRO in accordance with Law 9.430/96, article 79 and its respective regulation. Despite the fact that Brazilian Constitution imposes the necessity of having energy clean projects subsidized by old kinds of energy, when Brazil found huge reserves of oil in Rio de Janeiro and São Paulo coast, a complex and broad system of tax incentives were granted by both Federal and State Governments. This approach lead at that time to a substantial reduction of investments in the most relevant clean energy in the world - ethanol – even considering that Brazil, together with the United States, has almost 90% of the worldwide production.[136]

From another standpoint it is worth to mention that whenever we approach tax incentives in South America, in particular those concerned to special sectors of the economy like energy, there is still the difficulty of dealing with the situation where the two main Member states (Brazil and Argentina) are federated countries. This brings an even more complex scenario, once internal country states, which have strong tax powers, tend to grant tax incentives for regional undertakings like oil production in Patagonia (Argentina South) or a hydroelectric plant in Paraná (South of Brazil). Actually it aggravates any possible chance to coordination in terms of energy tax incentives, and leads to a fierce competition among those attempts to offer the cheapest energy as possible in the global market.

Therefore, apart from this reality it is important to highlight the beginning of a new mind set derived from the concern of the environment. In this new scenario, supported by environment treaties signed by Mercosur countries, we will describe some Brazilian experiences that could be raised as a good example in the region.

Although there is no communitarian legislation of what are the desirable energy tax incentives compatible with a common market, this could be an initial solution that would adjust the freedom and autonomy of federated entities to the respective constitutional ideals, especially in what refers to the ideal of environmental protection.

5.2. Tax incentives and State aids on environmental matter

In relation to tax incentives as environmental defense mechanisms, it is possible to affirm that some measures have been taken, i.e. the higher burden of the federal excise energy tax (CIDE, Law 10.336) which exempts ethanol and on the other hand heavily tax fossil fuels like diesel and nafta.

Notwithstanding this point, it is necessary to emphasize that, as opposed to Nordic countries, which have introduced real "green tax reforms", Brazil, on the treadmill of other Latin American countries, still lacks more effective measures in the use of taxes as instruments of environmental protection.

As Carlos Eduardo Peralta Montero[137] well identifies, this "green tax reform" model admits two practical versions, according to the intensity of the proposals: one with restricted or partial focus and the other with generalized or integral focus. The first version is exactly that of the Nordic countries, as for example, Finland which was the first country that implemented a tax on carbon gas emissions. It deals with an additional tax burden, different from the conventional energy taxation, which currently represents a 10% environmental levy.[138]

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136 http://www.afdc.energy.gov/data/10331 Source: Renewables Fuels Association.

137 Montero, Carlos Eduardo Peralta, Tributação Ambiental no Brasil. Reflexões para Esverdear o Sistema Tributário Brasileiro, in: Revista de Finanças Públicas, Tributação e Desenvolvimento da Universidade do Estado do Rio de Janeiro, v. 3, n.3 (2015).

138 About the topic, *see* Alberto Gago Rodríguez and Xavier Labandeira Villot, La Reforma Fiscal Verde. Teoría y Práctica de los Impuestos Ambientales. Madrid: Ediciones Mundi Prensa, at. 73-74 (1999).

On the other hand, in Brazil and in Mercosur, just as it occurs in the United States, Germany, Belgium and Great Britain, the so-called "green tax reform" acquires a restricted focus, such that environmental taxes still have a secondary role – with predominantly revenue purposes -, and are incorporated separately and with no connection with an integral tax reform.[139]

That is the reason that the tax incentives, granted in relation to already existing taxes in the Brazilian taxation system, with the purpose of stimulating or discouraging conducts of private entity, in virtue of environmental protection, gain special relevance on the matter of environmental taxation. Today the most significant project of Brazil in the field of environmental State aids concerns an incentive of financial origin and not strictly to a tax benefit granted to a private individual, which is the so-called "green ICMS (State VAT)", which will be discussed next.

Whereas in Brazil the Constitution itself lists the environment as a value to be protected by the three spheres of Power – Union, States and Municipalities – there is no hindrance for the taxes to be used in order to stimulate (positive non-taxation) or discourage (negative non-taxation) conducts that have environmental relevance. On the contrary, it is desirable for all tax species to include in their motivation the environmental criterion, whereby this general principle of economic activity, provided in art. 170, clause VI, of the Constitution of the Federative Republic of Brazil,[140] becomes considered at the time of application of the Law.

Thus, when we talk of "green tax reform" in Brazil we remit immediately to the idea of reutilization of tax species already in effect, through the granting of benefits that may stimulate or discourage relevant conducts, from the point of view of environmental protection, or even, through entailment of the destination of certain species for environmental purposes.

It is the case, for example, of the Tax on Ownership of Motor Vehicles (IPVA), whose fees in cases of use of less harmful fuels to the environment are smaller. It is the responsibility of each State to define this taxation, in accordance with the rule set forth in art, 155, paragraph 6 of the Constitution, which permits the adoption of differentiated fees/fractions of the IPVA, as a result of the type and use of the vehicle, subject to minimum fees set by the Federal Senate.

There are even environmental fees, under the jurisdiction of the three federated entities – Union, States and Cities. However, aside from insipient developments, they disregard environmental criteria in their structures.

But, it is in the so-called "green ICMS" or "ecological ICMS" that is a highlight of the Brazilian environmental taxation policy, although the "green ICMS" does not refer even to a tax benefit, or even to a State aid. The so-called "green ICMS" constitutes, in reality, the consideration of environmental indicators as adequate criteria to increase the revenue percentage of the ICMS which is forwarded to the Cities. That is, it is a financial indicator of forwarding of revenues and not strictly speaking a tax incentive, since it is intended for the federated entity itself and not to the private entity.

Likewise, it does not constitute a new tax, but rather, the introduction of new ICMS (State VAT) resource redistribution criteria, which reflects the economic activity level in the Cities in conjunction with the

139 *See* Montero, Carlos Eduardo Peraltam, supra note 136.

140 "Art. 170. The economic order, founded on the appreciation of the value of human work and on free enterprise, is intended to ensure everyone a life with dignity, in accordance with the dictates of social justice, with due regard for the following principles:[…] VI - environment protection, which may include differentiated treatment in accordance with the environmental impact of goods and services and of their respective production and delivery processes".

preservation of the environment. Initially, it was born as a form of compensating the Cities for the restriction of use of the ground in protected sites (conservation units and other specific areas of preservation), since some economic activities are restricted or even prohibited at specific sites so as to ensure their preservation. Today, a broader view shows that it is an excellent means of motivating the Cities to create or defend the creation of more protected areas and to improve the quality of already protected areas with the intention of increasing tax collection through forwarding of revenues proceeding from the States.

The ICMS can further be used with the objective of stimulating or discouraging conducts of private entities in relation to the environment, however, because it concerns a tax under state jurisdiction, it falls on every member State of the Federation to define the reductions of tax burden that it understands suitable in relation to this tax. Because it concerns a tax of high strategic relevance, the benefits granted in relation to it must be in consonance with the public environmental protection policies at the exact proportion to which they are intended, such that the incentive does not extrapolate the objectives related to environmental protection, under the penalty that they might constitute unjustified privileges in specific economic sectors.

Finally, there are some bills being processed in Congress, in order to reformulate the Brazilian taxation system in the light of environmental policies, such as PLP no. 73/2007, for creation of a CIDE for greenhouse gas emission, and PLP no. 493/2009, which permits the differentiated tax treatment of products and services as a result of possible impacts caused to the environment, among others.

5.3. Final considerations

As we have seen, taxes incentives represent today a very important instrument to stimulate clean energy. In Mercosur, besides the absence of a consistent set of rules regarding tax incentives within the block, the use of already existing taxes in the legal systems of the countries has been common, with non-fiscal ends, for purposes of environmental custody.

This is, however, a good opportunity to tackle the theme with the seriousness that it deserves, so that taxes may be used as well so as to provide environmental defense, with the possibility, even, of control of taxes that do not adequately comply with its environmental function, or even, measures of fiscal nature that may extrapolate the objectives related to environmental custody such as the “green ICMS” (State Tax) above mentioned.

6. The China Practice and Experience

The discussion of the relationship between energy taxation and State aid in the EU or similar mechanisms in the other sovereign states such as the dormant commerce clause in the US seems not a necessarily serious or relevant issue in China. There does not exist legal provisions or norms that require the government to balance the use of tax incentives and concessions relating to energy and the need of protecting an internal, common market in China. This is attributable primarily to the political design of the government system and legal institutions in respect of state power allocation and coordination in the country. Until now China has not yet had any tax directly targeting on the environment and energy, but the Chinese government has made it very clear in recent years that it will use various measures including the market-based instruments such as environmental taxation and emissions trading to promote energy conservation and upgrading as well as

environmental protection. Moreover, some existing taxes that have direct or indirect relationship with consumption of energy have been used for purposes of increasing energy efficiency, reducing energy wastage, and adopting new types of energy by way of tax incentives and concessions. The application of these tax incentives does raise issues with regard to the development of the market economy across regions within the country.

6.1. The Constitutional design of state powers and the making of tax law and policy

First and foremost, unlike Brazil or the US, China is a unitary state according to the Constitution of the PRC.[141] Article 3 of the Constitution clearly provides that all government institutions are under the uniform leadership of the Central Government, which refers to the government in Beijing. The notion of "democratic centralism" is adopted in the Constitution to mean that the state's functions and powers are divided into central and local levels with the unified leadership of the Centre.[142] Local governments are the agents of the Central Government at the three local levels: the province, the prefecture, and the county.[143] While the Central Government exercises uniform leadership of state powers, the local governments have been granted a wide range of initiatives to implement national laws, regulations and policies within their jurisdictions.

In terms of taxation, the Constitution does not contain any specific provisions directly relating to tax-law making. Article 56 of the Constitution is the only article on taxation, which provides that Chinese citizens have the obligation to pay taxes in accordance with the law. The essential question, what is "law" for tax purposes, is however not clear under the Constitution. The term "law" has been used in a number of articles with different underlying meanings in the Constitution. In the narrowest sense, the term only refers to the laws enacted by the National People's Congress (NPC) and its Standing Committee (NPCSC). For example, Article 89 of the Constitution stipulates that the State Council, which is the highest executive organ of the government, may adopt administrative regulations in accordance with the Constitution and other laws. However, in the broadest sense, the term can refer to all legally binding rules issued not only by the legislature but by administrative agencies at various levels.[144]

The Constitution contains no provision providing that the legislative power to enacting taxes should be reserved to the NPC and NPCSC. In practice, the NPC has delegated the tax-law making power to the State Council for quite a number of times. In 1985 in particular, the NPC granted blank delegation to the State Council to make rules with regard to issues on "reform of the economic system and opening to foreign countries". This has allowed the State Council to enact many key administrative regulations including regulations on taxation that are essential and indispensable to the development of the economy since the 1980s. The most significant tax reform around 1994 was taken place on the basis of such delegation. This very broad delegation is still considered valid today.

In 2000, the Law on Legislation was promulgated by the NPC, which for the first time provided clear rules restricting the delegation of the power to make tax laws. Article 8 of the 2000 Law on Legislation lists a number of matters that must be governed by the laws enacted by the NPC and NPCSC. There is a division of the

141 The current Constitution of the PRC (1982) was enacted by the National People's Congress (NPC). It was amended in 1988, 1993, 1999 and 2004.

142 Constitution of the PRC, art 3.

143 Constitution of the PRC, art 30.

144 Law on Legislation (passed by NPC, 15 March 2000, effective 1 July 2000, amended 15 March 2015), arts. 87-91.

legislative power between the two bodies of the national legislature. The NPC has the exclusive power to make "basic laws" relating to state sovereignty and fundamental issues on criminal offences, civil affairs, the State organs and other matters.[145] Accordingly, the NPCSC has the power to enact laws other than those to be enacted by the NPC.[146] Nevertheless, under the 2000 Law on Legislation, "the basic economic system and basic systems of public finance, taxation, customs, finance and foreign trade" were included in the list of reserved law-making power to the national legislature. However, the Law did not specify what the "basic system" of taxation means.

The Law on Legislation was amended in 2015, with much clearer provisions on a number of important matters. As regards taxation, the previous ambiguous provision was replaced by a detailed provision stipulating only law shall be enacted on the basic system of taxation such as the "establishment of taxes, determination of tax rates, and tax collection and management".[147] This is viewed as a significant improvement by scholars and commentators in the country. On the other hand, Article 9 provides that where laws have not been enacted on a matter specified in the list, the NPC or NPCSC may authorize the State Council to issue administrative regulations according to actual needs. This article affords the legal basis for the State Council to exercise delegated power to make tax rules and policies when needed, notwithstanding the reservation article under the Law on Legislation.

This delegation raises two separate issues. First, Article 9 amounts to a formal authorization of making tax rules by executive fiat. This is *prima facie* inconsistent with the rule of law, a principle that the Chinese government strives for,[148] but on the other hand if the legislature is unable to act under certain circumstances, it would be necessary that some government body could step into the void. In practice, it is rather common that the State Council further delegates the tax-law making power to the Ministry of Finance (MOF) and the State Administration of Taxation (SAT), the two principal central departments responsible for the implementation of taxes. The MOF and SAT have been enacting hundreds and thousands of tax circulars and introducing a variety of tax policies for economic and social development purposes over the years. Although there has been criticism on the *de facto* tax-law making by executive agencies, the MOF and SAT do not have the authority to pass tax rules and policies without any constraints. They are required to comply with the substantive and procedural guidelines set out by relevant laws.[149] Secondly, the laws enacted by the national legislature are often skeletal in nature, leaving much greater room for the executive to fill out the details than is the case in other developed jurisdictions. This is not necessarily detrimental and probably even necessary given the need of providing detailed and clear rules for the taxpayers due to the peculiar nature of taxation as a means of extracting money from them. However, a caveat must be made in this regard, that is, the subordinate legislature should be clear, consistent with the national legislature's framework and applied uniformly and fairly to all taxpayers across the country. This may take a long way to achieve and undoubtedly entail significant efforts from the executive body.

In addition to this *de facto* horizontal decentralization of the tax-law making power at the central level, there is also a type of vertical decentralization of the tax-law making power at the local levels. As noted earlier, China is a unitary state. The Constitution only endows people's congresses (local legislature) at the provincial level with the power to make local regulations. Such local legislative power has been further extended to the people's congresses of provincial capital cities, certain "relatively large cities" and cities designated as special economic

145 Constitution of the PRC, art. 7(2).

146 Constitution of the PRC, art. 7(3).

147 Law on Legislation (2015 amendment), art. 8(6).

148 Constitution of the PRC, art 3.

149 Typically, Law on Legislation (2015 amendment), arts. 80, 81, 83, 84(1), 85(1), 86(1).

zones by the Law on Legislation[150] and the Organic Law of Local People's Congresses and Local Governments. The corresponding level local governments are similarly authorized to make local rules to implement national laws, administrative regulations and local regulations within their respective jurisdictions.[151] In any event, however, local regulations and rules cannot enact matters on taxation since they are reserved legislative matters to the national legislature.

It seems that *prima facie*, China has a highly centralized tax legislative system and the local governments are limited in their powers to make tax rules and policies. In practice, however, a different conclusion may be drawn through the examination of tax incentives applied by the local governments. During the last three decades, local governments have offered a variety of tax incentives to foster local economic growth, and to fulfill other objectives they desired. Some of incentives have gone beyond the boundary of higher tax laws and regulations and caused harmful or unfair competition between different regions. The Central Government has continuously made efforts to curb the inappropriate uses of those tax incentives in order to keep the application of tax policies consistent throughout the country and to reduce harmful tax competition across the domestic market. The difficulty is however that China is a big country and has rather diversified and uneven economic development across the country. The Central Government is unable to supervise the use of various actual tax incentives by the local governments. The regional diversity and the difficulty of supervision means there is scope for local interpretation and implementation of laws and policies at discretion. To attract direct investment and promote local market development, local governments would have a natural tendency to use tax incentives in a number of forms such as "pay first and refund later" as "assistance" for business entities in their region. The *de facto* leeway for local offices to interpret laws and policies differently may lead to State aid at the local levels through interpretations.

The most recent attempt of tidying up local tax incentives was made by the State Council in 2014. The State Council issued a circular, which expressly stated that it is necessary to crack down on tax incentives that lack legal basis so as to promote a unified national market, improve resource allocation, facilitate the implementation of national macro-economic policies, and to prevent local protectionism, among other things. The central government was very much determined to get concrete cleaning-up action done by local governments.

This would be a laudable measure as many local governments have indeed used tax incentives to circumvent national laws, regulations and policies to foster local economic interests. Put aside the validity issue of those local tax incentives, the existence of the incentives does harm to the development of the market in the country in a more equal and even manner. However, the effort was in effect in vain. In March 2015, the State Council issued another circular indicating that the cleaning-up action will be implemented upon separate arrangement. Apparently, "implemented upon separate arrangement" is a euphemism for suspension indefinitely. China's Central Government, though powerful on paper, has had to compromise with the local governments from time to time. One possible explanation for such compromise is that as China's economy is slowing down, the Central Government is rather concerned that continuing the cleaning-up action would further dampen the local economy. It is also argued that the crackdown on tax incentives would frustrate the legitimate expectation of taxpayers to whom various tax incentives in question have been provided. Whatever the reason, the Central Government has had to recognize the validity of those incentives provided or guaranteed under the contracts signed between local governments and business entities concerned, at least for the time being.

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150 Law on Legislation (2015 amendment), art. 72.

151 Law on Legislation (2015 amendment), art. 82.

6.2. Tax incentives and the protection of the environment

For a long time, the protection of environment has been regarded as a basic national policy in China. Article 26 of the Constitution clearly stipulates that the State "protects and improves the environment and the ecological environment", and it "prevents and controls pollution and other public hazards". In recent years, given the serious concern about pollution and other environmental problems as well as the worries about energy safety and security, the Chinese government has introduced many environmental tax incentives to encourage the taxpayer to reduce pollution and reserve energy. According to the SAT, there are 43 types of environmental tax incentives provided by the government departments at the national level, making 6.5% of all tax incentives adopted by the Central Government. Despite the fact that environmental tax incentives have been widely used in China, there is a lack of detailed rules regulating environmental tax incentives.

The Environmental Protection Law authorizes governments to adopt tax incentives to encourage enterprises to reduce pollution, but it does not provide any further instructions. Rules on tax incentives relating to environment protection are scattered in various tax laws and regulations. For instance, according to Article 27 of the Enterprise Income Tax Law, enterprises are exempt from taxation, or pay taxes at a reduced rate, on the income derive from qualified environmental protection and energy and water conservation projects. In addition, the MOF and SAT have been authorized to determine the scope of the so called "qualified environmental protection and energy and water conservation projects".

Currently, unlike the EU, China does not have a comprehensive energy tax regime. Nevertheless, it has two types of taxes relating to energy, i.e. resource tax and consumption tax. The resource tax covers various mineral resources, including oil, gas and coal. The tax is a shared revenue source between the Central and local governments. While the Central Government collects all revenues from offshore oil enterprises, all other revenues go to the local governments. The consumption tax in China is an equivalent of excise tax elsewhere. For energy conservation purposes, the tax applies to the use of petrol and diesel. Moreover, the two taxes on vehicles - the vehicle acquisition tax and the vehicle and vessel tax - have an indirect relationship with the consumption of fuel. The former is a one-off tax and applied at the time of acquisition, while the latter is an annual tax and imposed according to the types of vehicles. The Centre collects all the revenues from the former while the local governments take all revenues from the latter.

Except for the vehicle and vessel tax that is levied according to law, the other three taxes have been applied by administrative regulations issued by the State Council. The relevant law and regulations contain no provision that authorizes local governments to offer tax incentives. Consequently, it is illegal for local governments to adopt any energy tax incentives. In fact, local governments lack motivations to adopt energy tax incentives. In China, the areas that are rich in energy products are generally undeveloped and the local governments in those areas are eager to collect more taxes from energy products. In addition, even if some local governments provide energy tax incentives against the law or regulations, those incentives are unlikely to do harm to the unified national market, because the large state-owned enterprises (SOEs) such as Sinopec and PetroChina have a monopoly over energy products supply and the energy sector is under tight government control.

Given the grave environmental problems in the country and heavy pressure from international partners, the Chinese government has expressly signaled a strong will of employing various measures to address environmental problems in recent years. It is expected that China will introduce an environmental protection tax soon. As a matter of fact, a draft bill on such tax was released for public consultation on June 10, 2015.

Under this draft bill, local governments are granted the power to adopt certain environmental tax incentives for environment protection purposes. For example, article 14 of this draft allows local governments to provide policy supports to the enterprises and public institutions investing in special equipment for automatic monitoring of pollution sources. If this draft is eventually adopted, local governments would be given much discretion to implement the policy, which, without sufficient supervision, may lead to abuses of tax incentives in practice.

7. Conclusions

Two international scenarios have to be considered to regulate tax incentives in general and energy taxation in particular: on the one hand, the law governing subsidies in the WTO (the SCM Agreement); on the other hand, the TFEU, acting at a supranational level. Both legal backgrounds are in constant interaction and affect the internal national tax systems, but they have different objectives and differences in their scope, definition and application. Then, each legal framework should be addressed in the light of its own objectives. Nevertheless, comparing both legal systems can provide a common tax platform of discussion with regard to the multi-level framework of tax incentives and can suggest alternative approaches.

The EU State aid regime is an original way to protect the internal market and indirectly to harmonize energy taxes. If we look at its rationale, it has been suggested that TFEU State aid rules share more chromosomes with the internal market rules – the rules on free movement – than with its competition or antitrust rules.[152] Other authors note the hybrid nature of the concept of `State aid´, between internal market and competition.[153] In any case, one question is clear on the way to fiscal integration in Europe: legal harmonization did not succeed in the field of energy taxation, except for the minimum level of taxation regarding taxes included on the scope of the ETD. The EU State aid control rules of environmental and energy taxes allow the European Commission to proceed against Member States who infringe the basic set of rules constituting the internal market. The rules require a constant balance between different goals and values among which the most important ones may be environmental protection, competition and trade, and, in an indirect way, competitiveness of national and European industries.

The US approach to maintaining a united market through the dormant commerce clause differs in several important respects from the European approach through the State aid rules. First, as a preliminary matter, the commerce clause analysis depends on the type of aid. It distinguishes between aid delivered through direct expenditures, which is not subject to dormant commerce clause scrutiny, and aid conveyed through tax expenditures, which is subject to constitutional review. The EU Treaty's State aid rules do not distinguish between direct expenditures and tax expenditures. As a result, US states have much greater freedom than EU Member States to use direct spending programs to achieve energy goals.

Second, the nature of the way in which the rules that protect the common market are developed is very different. In the US, the substantive rules evolve through case-by-case judicial interpretation of the commerce clause (a common law approach). In the EU, additionally, the European Commission establishes express guidelines governing permissible practices (a regulatory rulemaking approach, reinforced by Commission

[152] *See* L.Hancher, T. Ottervanger & P. Jan Slot, State aids in the energy sector, in L. Hancher, T. Ottervanger & P. Jan Slot, *EC State Aids*, Thomson Sweet & Maxwell, 458, (2006). Other scholars have discussed the interaction/overlap between EU State aid law and other EU law affecting taxation. This is the case of P.J. Wattel, *Forum: Interaction of State aid, free movement, Policy Competition and Abuse Control in Direct Matters*, 5 World Tax Journal 1, 128 (2013).

[153] *See* Jerónimo Maillo, Seeking the rationale behind the current concept of Fiscal State Aid: the EC Draft Notice and beyond. In: Pasquale Pistone and Marta Villar (eds) Energy taxation, environmental protection and State aids: Tracing the path from divergence to convergence. IBFD, Amsterdam, 227-240 (2016).

and judicial interpretation). As a result, the US states have no precise set of rules for energy-related tax expenditures, whereas the EU's Member States have the benefit of the very specific State aid guidelines and regulations that the Commission issued in 2014.[154] Hence, the EU's approach generates much more explicit parameters that put governments on clear notice of the boundaries for tax expenditures.

Third, the US and EU draw different substantive lines governing which energy-related tax expenditures are permissible. The US constitution focuses primarily on whether tax expenditures discriminate against interstate commerce by providing beneficial treatment to certain in-state activities at the expense of interstate enterprises, with a very limited opportunity to defend a measure based on the inability to achieve the public purpose in a nondiscriminatory way. The EU Treaty also embodies the principle that state subsidies should not distort competition.[155] However, it recognizes specific situations in which State aid is or may be compatible with the internal market,[156] and it allows aids to distort the internal market if it serves "an important project of common European interest."[157] This recognition that the common public interest may outweigh market distortion provides a more liberal basis for justifying aid than the tax principles that Court has found within the dormant commerce clause.

Despite this ostensibly more liberal approach, the EU's State aid rules may have a greater deterrent effect on the use of green energy-related tax expenditures than the US dormant commerce clause. The European Commission's regime for energy tax expenditures contains some very specific criteria for which there are not comparable US requirements. The 2014 General Block Exemption Regulation (GBER)[158] authorizes aid without prior notice to and approval by the European Commission for very specific types of aid for energy-related purposes, provided they meet certain conditions.[159] Those conditions, for example, limit certain types of aid to measures to improvements that exceed EU standards,[160] cap the intensity of aid,[161] limit the circumstances in which aid can be granted for biofuels and hydropower installations,[162] and apply thresholds for the level of aid that can qualify for block exemption.[163] In the US, states can use their discretion to determine what level of aid to grant and for which types of activities.

Energy-related aid not falling within the GBER is subject to the Environmental and Energy State Aid Guidelines.[164] The Guidelines contain both general and specific criteria that cover a wide range of issues not directly relevant to the US inquiry about whether tax expenditures discriminate against interstate commerce, such as whether the aid addresses a market failure, whether it creates an incentive effect,[165] whether the aid is the minimum required to achieve the incentive effect, and the contribution to environmental protection.[166] These substantive, environmentally-related criteria create a high and rigorous benchmark for justifying the public value of the aid. The dormant commerce clause contains no similar benchmarks; a state must only be sure that it does not discriminate against interstate commerce. If aid in the EU does not fall within the GBER

154 European Commission Guidelines on State aid for environmental protection and energy 2014-2020 (supra note 25).

155 Treaty, Article 107(1).

156 Treaty, Article 107(2), (3).

157 Treaty, Article 107(3)(b).

158 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 (supra note 23),

159 Id. Articles 38-43.

160 Id. Articles 38(2), 44(4).

161 Id. Articles 38, 41.

162 Id. Article 41.

163 Id. Article 4.

164 European Commission Guidelines on State aid for environmental protection and energy 2014-2020 (supra note 25).

165 Id. Section 3.1.

166 Id. Section 3.2.

or the Guidelines, it may still be permissible if it meets the Treaty's standards, leaving the situation analytically somewhat closer to a dormant commerce clause standard.

Fourth, there are significant procedural differences in how the regimes operate, which can affect the extent to which governments offer tax expenditures. In the US, the issue of compliance with the dormant commerce clause arises only when a party that has standing to sue (such as a state government representing its citizens or an injured industry) chooses to challenge another state's tax expenditure on the grounds that it burdens interstate commerce.[167] A state might offer a tax expenditure that violates the dormant commerce clause, but the measure will survive legally if no one chooses to challenge it. The European Commission is very much involved in the process of establishing substantive criteria for State aid, approving aid, and monitoring its use[168] Under the GBER, certain types of aid are authorized without prior notice to the Commission, but states must still comply with reporting and monitoring requirements.[169] Under the Guidelines, Member States will notify the Commission of aid *ex ante* and seek its assessment of whether the aid is compatible with the Treaty under the Guidelines' criteria.[170] These EU procedures create a clarity and discipline that does not exist under the US dormant commerce clause. It is possible that this procedural rigor may deter aid in the EU, and it is also possible that legal uncertainty in the US may also deter measures. It is difficult to speculate about the relative impact, but intuition leans towards thinking that procedural rigor might be more likely to deter use.

The end result is that the US rules for energy-related aid are less liberal in some respects, more liberal in other respects, less precise, and not subject to a rigorous review process apart from the will of a party to litigate. As a result, states within the US have greater flexibility to use green tax expenditures that is structured to avoid discrimination but also have less certainty about which practices might run afoul of constitutional limits.

The concept of State aid is not regulated in the scope of the Southern Common Market, Brazil and Mercosur. By comparison with American and European models, we can observe that the current regime is closer to the American model, where competitiveness between the entities of the federation thrives in the absent of *a priori* control.[171] China, for its part, has no rule or principle that is similar to the "State aid control" regime in the EU or the federal dormant commerce clause in the US. As China and the EU have very different energy markets as well as energy tax systems, there may be no imminent need for China to establish such regime. Notwithstanding this, given the enormous variation in the implementation of tax laws and policies from province to province, there may be a case for empowering the Central Government to step in and override provincial (and lower level) discretion or practice where it distorts and inhibits the adoption of national standards.

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167 *See generally* Peter D. Enrich, Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business, 110 Harvard Law Review 377, 409-22 (1996). Enrich notes that it may be difficult for an industry that chooses not to take advantage of a tax expenditure may have difficulty showing injury sufficient to justify standing. Id. at 412. Standing rules in state court may be more liberal than in federal court. Id. at 414-17. As indicated above, the United States Supreme Court has held that citizens of a state do not have standing in federal court to challenge the use of tax expenditures on dormant commerce clause grounds. Cuno v. DaimlerChrysler, Inc. 547 U.S. 332 (2006). *See also* Tracy A. Kaye, The Gentle Art of Corporate Seduction: Tax Incentives in the United States and the European Union, 57 Kansas Law Review 93, 128-36 (2008).

168 *See generally* Tracy A. Kaye, The Gentle Art of Corporate Seduction: Tax Incentives in the United States and the European Union, 57 Kansas Law Review 93, 128-42 (2008).

169 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 (supra note 23), Chapter II.

170 European Commission Guidelines on State aid for environmental protection and energy 2014-2020 (supra note 25), Section 3.

171 *See* Marcos Andrés Vignas Catao, Current Scenario of the Tax Incentives in Brazil: A comparison based on the concepts of State Aid in Europe and of the Commerce Clause in the United States, Intertax Vol. 35, 638-646 (2007).

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Abstract: This research activity aims to make a comparative study between EU State aids regulation on energy taxation and other legal regimes that pursue similar goals.

The analysis mainly focuses on the differences and similarities between the European Union (hereinafter, EU) and the United States (hereinafter, US), although some references to the World Trade Organization´s (hereinafter, WTO) rules are made. The experience in Brazil and China is also addressed, due to the importance that both countries have as emerging markets with great dimensions.

Legal instruments, case-law, constitutional principles and other concepts such as market competitiveness or environmental goals lead this comparative analysis. The ultimate aim is to determine where are the limits on states' powers on the relative degree of freedom or constraint under different forms of government in diverse countries focusing on energy taxation.

Keywords: *Energy taxation, State aids, European Union, United States, China, Brazil.*

Ref. 553321-EPP-1-2014-1-ES-EPPJMO-PROJECT

Co-funded by the Erasmus+ Programme of the European Union

Ref: DER 2014-58191-P

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ISBN: 978-84-16477-46-3
9 788416 477463