The Gift Tax and the Free Allocation of Emission Allowances: a commentary on the European Court of Justice's judgment of 26 February 2015

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The disparity of national laws on inheritances and gifts among the Member States of the European Union is a potential source of internal market problems, with the Court of Justice of the European Union (hereinafter, CJEU) recently making a pronouncement on the legality of levying the gift tax under Czech legislation on emission allowances received free of charge by electricity producers in 2011 and 2012 within the framework of carbon trading.

Introduction

Through the establishment and start-up of a European market in greenhouse gas emission allowances (hereinafter, EU Emissions Trading System or EU ETS), Directive 2003/87[1] aims to contribute to meeting in a cost-effective way the greenhouse gas emission target commitments of the European Community and its Member States under the Kyoto Protocol.

To this end, the EU ETS distributes greenhouse gas emission allowances or caps among installations in the energy and industrial sectors that are covered by Annex I to Directive 2003/87. Thus, the allowance, which gives the holder the right to emit one tonne of CO_2 or the equivalent amount of another greenhouse gas, operates as a cap on the holder's actual emissions. That is, if the CO_2 emissions of an installation annually exceed the allocated cap, such installation has a choice between taking measures to reduce its own emissions – such as investing in more efficient technology or cutting back production – and buying the extra allowances it needs on the market, or a combination of the two. Such choice is likely to be determined by relative costs.

Preliminary matter

The request for a preliminary ruling was made in proceedings between ŠKO–ENERGO s.r.o. ('ŠKO–ENERGO') and the *Odvolací finanční ředitelství* ('Tax Appeal Board'[2]), concerning the payment of a tax on the allocation of greenhouse gas emission allowances for the years 2011 and 2012.

This request concerned the interpretation of Article 10 of Directive 2003/87/EC (entitled 'Method of allocation'), which provides that "*(f)or the three-year period beginning 1 January 2005 Member States shall* **allocate** *at least 95% of the allowances* **free of charge**. *For the five-year period beginning 1 January 2008, Member States shall allocate at least 90% of the allowances free of charge*." Note that the EU ETS was launched on 1 January 2005, start of the first three-year

[1] Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC. Amended by Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009.

[2] As translated by CJEU lawyer-linguists.

period (2005-2007), followed by the second phase running from 2008 to 2012, which coincided with the first commitment period of the Kyoto Protocol.

On the other hand, Article 6(8) of the Czech Inheritance, Gift and Transfer Tax Act no. 357/1992, as amended by Act no. 402/2010, provides that "(g)ift tax shall be charged on the acquisition free of charge of greenhouse gas emission allowances in 2011 and 2012 for the production of electricity in an installation which on or after 1 January 2005 produced electricity for sale to third parties and in which no activity to which greenhouse gas emission allowance trading relates is carried out other than the combustion of fuels … by an electricity producer"[3].

To which Article 7(a) adds that "the basis of assessment […] shall be the average market value of the greenhouse gas emission allowance on 28 February of the relevant calendar year multiplied by the number of allowances acquired free of charge for the production of electricity for the relevant calendar year"[4], said average value being published by the Ministry of Environment.

Pursuant to the foregoing, the *Finanční ředitelství* ('Tax Office'[5]) is claiming CZK 20,473,152 in gift tax (approx. EUR 752,350) over the greenhouse gas emissions allowance for 2011 and 2012; the average market value of the 2011 and 2012 allowances was approx. € 6.5/tCO2e.

In those circumstances, the *Nejvyšší správní soud* ('Supreme Administrative Court of the Czech Republic'[6]) decided to stay proceedings and refer the following question to the Court for a preliminary ruling: 'Must Article 10 [of Directive 2003/87] be interpreted as preventing the application of provisions of national law which make the allocation free of charge of emission allowances in the relevant period subject to gift tax?'[7], given that said article provides that during the period 2008-2012 Member States are to allocate at least 90% of the emission allowances free of charge.

Preliminary ruling

The CJEU recalls that the almost free (90%) allocation of emission allowances to all sectors concerned was intended to temporarily reduce the economic impact of the second period of the EU ETS so as to prevent loss of competitiveness in certain production sectors.

However, in line with earlier rulings, the CJEU states that neither Article 10 of Directive 2003/87 nor any other provision of the directive concerns the use of those emission allowances or expressly restricts the right of Member States to adopt measures which may affect the economic implications of using such allowances – for instance, determining the manner in which the value of the emission allowances allocated free of charge to producers is to be passed on to consumers, or reducing remuneration for electricity production by an amount equal to the increase in such remuneration brought about through the incorporation, in the selling prices offered on the wholesale electricity market, of the value of the emission allowances allocated free of charge[8].

Nevertheless, the CJEU adds that the adoption of such measures must not neutralise the principle that emission allowances are allocated free of charge. In this regard, the principle precludes not only the direct fixing of a price for the allocation of emission allowances but also the subsequent levying of a charge in respect of their allocation if they do not respect the 10% ceiling on the allocation of emission allowances for consideration.

In the present case, it is apparent from the documents before the Court that the gift tax at issue in the main proceedings is levied at a rate of 32% on

[3] Id.

[4] Id.

[5] Id.

[6] Id.

[7] Id.

[8] CJEU's judgment of 17 October 2013 in joined cases C-566/11, C-567/11, C-580/11, C-591/11, C-620/11 and C-640/11, Iberdrola SA and Others v Administración del Estado, EU:C:2013:660, paragraphs 28 and 29.

greenhouse gas emission allowances acquired free of charge for electricity production. Furthermore, such tax pursues objectives different from those of Directive 2003/87 and so cannot be regarded as a more stringent protective measure for the purposes of Article 193 of the Treaty on the Functioning of the European Union[9].

In response to the Czech Government's contention that the tax, in practice, is levied on less than 10% of the total value of the greenhouse gas emission allowances allocated by that Member State, the CJEU responds not only that the free of charge principle does not refer to the value of allowances, but, moreover, that the limitation to 10% of the number of allowances which may be allocated for consideration should be assessed from the point of view of operators in each of the sectors concerned and not in relation to all the allowances allocated by the Member State.

Accordingly, the imposition of a gift tax such as that at issue in the main proceedings is precluded if it does not respect the 10% ceiling on the allocation of emission allowances for consideration, which is a matter for the referring court to determine.

[9] See, by analogy, the judgments in Deponiezweckverband Eiterköpfe, C-6/03, EU:C:2005:222, paragraphs 49 and 52, and Azienda Agro-Zootecnica Franchini and Eolica di Altamura, C-2/10, EU:C:2011:502, paragraph 50.