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Spanish Supreme Court rules on hydrocarbon tax

Spanish Supreme Court ("SC") rejects elimination of exemption on hydrocarbon tax applicable to natural gas used to produce electricity or co-generate electricity and heat

Spain - Legal flash

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Key aspects

- **The SC** declares **the elimination of the exemption on hydrocarbon tax ("HT")** applicable to **natural gas used to produce electricity or co-generate electricity and heat** under Act 15/2012, on fiscal measures for energy sustainability ("**Act 15/2012**") **to be contrary to European Union law.**
- The SC considers that the **referral to environmental policy reasons** for creating an exception to the obligatory nature of the exemption is **purely formal.**
- Therefore, it considers **not applicable Act 15/2012,** which excludes the mandatory exemption and, therefore, the mentioned exemption does apply to the **natural gas** that was taxed in relation to the production of electricity and heat **between 2013 and 2018**.

Introduction

The SC has declared, in its **judgments of July 8, 2024** (ECLI:ES:TS:2024:3993), **July 22, 2024** (ECLI:ES:TS:2024:4261), and **July 24, 2024** (ECLI:ES:TS:2024:4296 and ECLI:ES:TS:2024:4299), that **the elimination of the exemption on HT** applicable **to natural gas used to produce electricity or co-generate electricity and heat** under Act 15/2012, on fiscal measures for sustainable energy ("**Act 15/2012**")**is contrary to European Union law**.

Background

Council Directive 2003/96/EC of October 27, 2003 restructuring the Community framework for the taxation of energy products and electricity ("**Directive 2003/96/EC**") established a **harmonized tax framework** for **energy products and electricity**, **to avoid distortions of competition**, **obliging the Member States to impose taxation on electricity,** while declaring the **exemption for the energy products used to produce that electricity**, so as to **avoid the double taxation** of electricity.

Article 51.2.c) of Spain's **Act 38/1992**, of December 28, on **Excise Taxes** ("**LIIEE**") regulated the **exemption** on HT **in relation to the production of electricity in power plants, the production and co-generation of electricity and heat in combined power plants, and the self-consumption of electricity in the facilities where it was generated**.

However, later, Act 15/2012, **removed** the mentioned exemption, **with effect from January 1, 2013**, based on two precepts: first **article 14.1.a) Directive 2003/96/EC**, which permits the Member States—based on environmental policy reasons—to impose taxation on energy products used to produce electricity; and second, **article 15.1.c)** of the same directive in relation to the combined generation of heat and electricity. This is particularly because, under Act 15/2012, the activities generating electricity from fossil fuels constitute large sources of greenhouse gas emission.

The elimination of the exemption was accompanied by the introduction of **a new exemption,** exclusively applicable to the manufacture and importing of products classified under the **NC 2705 code** and used (i)to produce electricity in power plants, (ii) to produce electricity or co-generate electricity and heat at combined power plants, or (iii) for self-consumption in the installations where the electricity was generated. We highlight that the **products classified** under the NC 2705 code are coal gas, water gas, lean gas and similar, excluding petroleum gas and other gaseous hydrocarbons. The code does not include biogas and natural gas, meaning that the elimination of the exemption continued to apply to acquisitions of those products and the new exemption did not benefit them.

However, later, the **exemption was re-introduced** to be **applicable to biogas and natural gas** with **effect, respectively, from July 1, 2018 and from October 7, 2018**, to avoid the tax from being transferred to the final prices during the period the prices of the wholesale market are set.
Following this legislative development, **between 2013 and 2018,** many **operators paid the tax** on the acquisition of the mentioned natural gas to produce electricity and heat, **without**

the possibility to apply the exemption. Those operators considered that the elimination of the exemption was contrary to European Union law because (i) it was not based on **environmental policy** reasons, and (ii) the regulation of the exemption in the directive is an order directed at the lawmaker producing a **direct effect.** Based on these reasons, proceedings were started to request a **refund** of the HT payments paid and to which the exemption was not applied.

This controversy has already been solved by the SC **in relation to biogas.** Specifically, in its judgments of **March 23, 2021** (ECLI:ES:TS:2021:1132) **and March 25, 2021** (ECLI:ES:TS:2021:1285), the SC ruled that **biogas used to produce electricity constitutes a direct exemption due to vertical direct ascending effect of Directive 2003/96/EC**.

However, those judgments **were not directly applicable** to the case of **natural gas** because, unlike biogas, it is a **fossil fuel.**

The new judgments issued by the SC in July 2024 address the **application of the mentioned exemption in the case of natural gas used to produce electricity**.

SC judgments

The SC ruled on the matters appealed, expressly referring to the **judgment of the Court of Justice of the European Union ("CJEU") of March 7, 2018** (**Cristal Union, case C-31/17**) in which the CJEU stated the **precise and unconditional obligation of the Member States,** in line with article 14.1.a) Directive 2003/96/EC, **to apply the mandatory exemption to the energy products used to produce electricity, including those used in the co-generation of electricity**, **without prejudice to** the **power** that, in relation to the matter at hand, is recognized to the Member States **to exclude that mandatory exemption framework and impose taxation on the energy products used to produce electricity due to environmental policy reasons**.

Based on the above, the SC analyzed whether that **imposition, justified on environmental policy reasons,** is in line with Directive 2003/96/EC. To do this, in this case, the SC referred to the doctrine in CJEU judgment of June 22, 2023 **(Endesa, case C-833/21,** ECLI:EU:C:2023:516), in relation to another fossil fuel, coal, from which it can be deduced that **that exception to the exemption under Directive 2003/96/EC must be understood as a «tax with a specific purpose»**, which is only justified if the following **circumstances** apply:

- There is a **direct link between the use of the revenue and the purpose of the tax in question**.
- If there is no direct link, the tax, in terms of its structure, including in particular the taxable item or the tax rate, is designed in such a way that it influences the **behavior of taxpayer**s in a way that facilitates ensuring better protection of the environment.

In relation to this, the SC clarifies that "(...) these circumstances **must derive from the provision itself in its legislative content**, without there being many **statements in the preamble of Act 15/2012**, **in relation to the environmental purpose, to prove that that is really the purpose of the tax."**

In this case, the **lawmaker justified the elimination of the exemption** in relation to the production of electricity in power plants and the production or co-generation of electricity and heat in combined power plants based on (i) **article 14.1.a) Directive 2003/96/EC** regarding the energy products used to produce electricity, and (ii) **article 15.1.c)** of the same directive in relation to the energy products used in the combined generation of heat and electricity.

However, as article 15.1.c) Directive 2003/96/EC **does not in any way authorize the suppression of the mandatory exemption under article 14.1.a)**, rather it **grants an additional possibility to offer a more favorable treatment of the energy products used in the co-generation of electricity and heat** (included in the previous exemption), the SC concluded that this "(...) erroneous understanding of the functioning of each of these regulations of EU law observed in the preamble shows that **the referral to the environmental policy reasons for the exception to the obligatory nature of the exemption is purely formal."**

Also, the SC upheld that **there was no allocation of the proceeds for the purpose of environmental policy, as the revenue is not related to the environmental policies**, an element that, we highlight, caused loss of the specific purpose in the **special tax on retail sales of certain fuels** in CJEU judgment of February 27, 2014 (Transportes Jordi Besora, case C-82/12, ECLI:EU:C:2014:108).

Regarding the **structure of the tax**, the SC considered that LIIEE, by regulating the HT, **does not divide electricity production into (i) the production of electricity in traditional power plants, such as the case of coal; and (ii) electricity produced in co-generation plants**. It stated "(...) the tax rate does not depend on environmental damage, nor on the type of industry or technology; the tax **is levied** generically, considering the **energy power of the natural gas consumed.**"

Therefore, according to the SC, the imposition of a **proportional tax rate** that considers the **calorific value of the natural gas** is **not relevant to influence the behavior of the producers of electricity in co-generation plants**, for the sake of achieving that **better protection of the environment.**

Consequently, after considering that the referral to environmental policy criteria mentioned in the preamble of Act 15/2012 is merely formal and that, therefore, the national regulations are not in line with European law, the **SC rendered Act 15/2012 inapplicable due to exclusion of the mandatory obligation, making the mentioned exemption applicable for natural gas that was taxed in relation to the production of heat and electricity.**

In this way, the SC protects the **requests for refund by those operators that had requested the refund of the HT payments made as a consequence of the elimination of that exemption**.

These SC rulings explore the possibility of a **recovery of the tax** by the companies that had acquired natural gas to produce electricity or to co-generate electricity and heat. This is not limited to those operators that started refund proceedings that are in the process of being resolved. Other operators that cannot start proceedings now to request refunds of payments unduly made in statute-barred years can consider using **other suitable proceedings** to try to **recover the amounts paid**.

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