ECJ: Electricity tax exemptions for electricity generation also to be granted for upstream and downstream operations.

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In its ruling dated March 9, 2023, in the case C-571/21, the ECJ clarified that electricity manufacturers are entitled to exemption from electricity tax for a large number of operations that are upstream and downstream of the actual generation of electricity, in accordance with an interpretation of national law that is consistent with EU law. The ECJ thus sets limits to the hitherto prevailing view in customs administration and case law.

How far does the electricity tax exemption for electricity used for power generation apply?

Subject of the proceedings is the taxation of opencast mines and coal-fired power plants under electricity tax law. The authority is of the opinion that electricity used for the extraction, preparation and transport of lignite as well as disposal of the ash after conversion to electricity, upstream or downstream of the specific technological conversion process, is not subject to the exemption. The Financial Court Düsseldorf decided to interrupt the proceedings in order to give the ECJ the opportunity to specify the conditions of the tax exemptions under EU law.

Article 14 (1) (a) sentence 1 of Directive 2003/96 restructuring the Community framework for the taxation of energy products (**Energy Tax Directive**) explicitly obliges EU Member States to grant tax exemptions in respect to electricity used to "produce electricity" (alternative 1) or "in order to maintain the ability to produce electricity" (alternative 2). Both provisions have been implemented into German law through Sec. 9 (1) No. 2 Electricity Tax Law (StromStG) in conjunction with Section 12 (1) No. 1 Electricity Tax Ordinance (StromStV).

Preparation of the energy carrier for conversion into electricity is subject to tax exemption

The first question of the Financial Court concerned the scope of the 1st alternative of Article 14 (1) (a) sentence 1 of the Energy Tax Directive. The Financial Court requested an opinion on the question of whether it already covered the extraction of lignite and its preparation (which includes crushing the coal, separating foreign particles and crushing it to the size required for operation in the boiler) for conversion into electricity. The ECJ denied the applicability of the electricity tax exemption to the extraction of lignite, but stated unequivocally that the preparation of the coal must be subject to the exemption.

This is not (any longer) to be seen as the production of a fuel - in contrast to the circumstances covered by Art. 21(3) of the Energy Tax Directive. Rather, this process is already so directly connected with coal-fired power generation and indispensable for it that the corresponding electricity consumption must be regarded as "used to produce electricity" within the meaning of alternative 1. The ECJ also justifies the allocation to the process of electricity generation itself with the technical and legal necessity of (only) converting coal into electricity in an efficiency-optimizing manner.

Transport and storage of the energy carrier also covered - at least on the power plant site

The second question referred for a preliminary ruling concerned the interpretation of alternative 2 of Art. 14(1)(a) sentence 1 of the Energy Tax Directive. Specifically, the Financial Court asked whether the operation of so-called bunker facilities (for the temporary storage of lignite) and means of transport required for the permanent operation of the power plants are also to be regarded as operations used "in order to maintain the ability to produce electricity " (and to be exempted from the electricity tax) within the meaning of the provision. In this respect, the ECJ starts from the – apparent – premise that the existence of both alternatives implies two different areas of application. The wording of the provision suggests that it is intended to cover processes upstream and downstream of the actual generation of electricity, insofar as the corresponding electricity consumption directly maintains the ability to generate electricity. In its subsequent subsumption, the ECJ first distinguishes spatially between processes that take place on the power plant site and those that still occur, for example, in the area of the open pit mine. The former, i.e., operations involving the storage of lignite on the power plant site or its transport across the site – using coal excavators or conveyor belts, for example – are to be exempted from the electricity tax without further qualification, since they are necessary to maintain the generation capability.

With regard to the (short-term) storage of lignite in the opencast mine bunker and the transports from the opencast mine to the power plant, the ECJ first states that these operations in turn tend to be assigned to the sphere of fuel production, i.e., coal extraction, and therefore cannot be subject to the tax exemption under Art. 14 (1) a Alt. 2. However, the ECJ expressly leaves it to the Financial Court to identify a closer functional ("direct") connection of these processes with the generation of electricity or the maintenance of the ability to do so in individual cases, and to exempt the corresponding electricity consumption from the tax.

From the ECJ's statement that alternative 2 covers processes upstream and downstream of electricity generation, it follows that the disposal of necessary waste products, in the case of lignite-fired power generation the ash remaining in the boilers, must also be included. Legally and technically, coal-fired power generation cannot take place without proper disposal of the ash produced.

Extent of tax exemption pursuant to Art. 14 para. 1 lit. a p. 1 of the Energy Tax Directive must always be measured on the basis of the specific type of electricity generation

The example of the inclusion of ash also illustrates that the ECJ ruling requires the customs administration and the courts to take into account differences between different types of generation and energy sources in energy taxation. It is not possible to make a blanket assessment of the simple technological process from which electricity generation directly follows. Rather, on the one hand, there will be energy sources that require almost no immediate power consumption - think of solar or wind energy, for example, where energy sources and the technology that processes them come together without any physical effort. On the other hand, there are - at least for the foreseeable future - types of electricity generation that involve a whole series of upstream and downstream indispensable energy consumptions, all of which are subject to tax exemption. This is also the only correct result in terms of avoiding double taxation - which, according to the present ruling, is the actual purpose of the exemption. Against the backdrop of the ECJ ruling, the view held by the BFH that processes that are downstream of the actual generation of electricity are not to be exempt from tax (BFH, ruling of April 30, 2019, VII R 10/18) is unlikely to be upheld.

For companies active in electricity generation, the new case law means that processes must be reviewed and, if necessary, appeals lodged against the customs administration's overly narrow interpretation of the electricity tax exemption.

BLOMSTEIN will closely follow further developments in case law and administrative practice. If you have any questions, please do not hesitate to contact Dr. Roland M. Stein and Dr. Leonard von Rummel.