

EU Environmental Border Tax Adjustments (BTAs): Typology and Legal Context

CONTEXT

For more than 20 years, States have been looking for a global solution to climate change. Although progress has been made, current agreements remain insufficient to effectively tackle climate change and other global environmental challenges [World Bank Report, "Turn Down the Heat", 2012]. In addition to international climate action (i.e. the 'first-best option'), some countries and regional groups have unilaterally adopted climate policies at the domestic level. However, national and regional action is limited by two main risks: (1) a risk of loss of competitiveness and (2) a risk of carbon leakage.

In the light of these risks, a **second-best choice in mitigating climate change** could be **unilateral action, complemented with environmental border tax adjustments**.

Proposals:

- **In the European Union:** Reference to the potential introduction of a "**carbon equalization system**" in order to "**put installations from the Community which are at significant risk of carbon leakage and those from third countries on a comparable footing**" [Recital 25 Directive 2009/29/EC ("Aviation Directive")]
- **In the United States:** Various proposals, e.g. Proposition to use carbon adjustments in order to prevent carbon leakage and "**promote a strong global effort to significantly reduce greenhouse gas emissions**" [U.S. Congress, American Clean Energy and Security Act of 2009, H.R. 2454, Sec. 761, p. 1087]

RESEARCH QUESTION

"How and to what extent could border tax adjustments be used in order to complement current and future national/regional climate policies ?

- Interdisciplinary topic but emphasis on legal aspects → Critical legal perspective
- The main objective is to study the legal conditions to the establishment of environmental tax adjustments at the European borders

HYPOTHESES

BTAs « in se »: New EU Harmonised Tax

This hypothesis has already been widely developed by scholars, mostly economists [e.g. Majocchi & Missaglia, 2002; Burniaux, Chateau, Duval, 2010]

- Sometimes referred to as "environmental custom duties", "green tariffs", "carbon tax adjustments".
- Generally defined as "*any fiscal measures which put into effect, in whole or in part, the destination principle (i.e. which enable exported products to be relieved of some or all of the tax charged in the exporting country in respect of similar domestic products sold to consumers on the home market and which enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of similar domestic products*" [OECD; WTO, Report of the WP on 2 December 1970 (KL/3464), BISD 18S/9]

Sub-question:

- Are BTAs similar to existing taxes (custom duties, VAT, excise duties) or *sui generis*?
 - "Carbon-Motivated BTAs: Old Wine in Green Bottles?" [Lockwood & Whalley, *World Economy*, 2010]

« BTAs » through Transfer Pricing & Corporate Taxation

This hypothesis aims at including an environmental factor in the methods used to tax multinational enterprises (i.e. transfer pricing rules). More specifically, the objective is to determine to what extent environmental criteria could be taken into account in the allocation of profits between associated enterprises.

- Based on the analysis of the "arm's length principle" and its alternatives (e.g. "formulary apportionment")

Question:

- How can environmental factors best be taken into account in the allocation of profits between associated enterprises?

ANALYTICAL PERSPECTIVES:

The research focuses on three fundamental questions: the legality, the coherence & the impact of each hypothesis.

Legality

What are the legal limits to the establishment of BTAs?

- National level: general tax principles
- European level : TFEU (e.g. art. 107-115; 192; 194) and TEU (e.g. art. 20)
- International level: WTO (e.g. art. II, III, XX GATT); UNFCCC (e.g. principle of common but differentiated responsibility)
 - Most research projects only focus on the compatibility of BTA's with the WTO legal framework [e.g. Horn & Mavroidis (2011); Low, Marceau & Rein (2011); Ekhardt & Schmeichel (2009)]. This research project goes further by looking at the rationale behind BTAs, their tax design and the conditions surrounding their eligibility under WTO law.

Coherence

To what extent could BTAs be supportive of current EU policies?

- EU internal policies (e.g. environmental policies)
- EU external policies (e.g. development/cooperation policies)

Impact

What could be the impact of the establishment of BTAs on economic actors? What would be the impact of BTAs on developing countries?

- Avoidance behaviour (tax fraud/evasion/avoidance)
 - Corporate Social Responsibility
 - Principles of good governance (e.g. information exchange)
- Principle of common but differentiated responsibility vis-à-vis developing countries
 - How to ensure the effectiveness of BTAs?

Dr. Alice Pirlot (FNRS Postdoctoral Research Fellow at Louvain University) - Supervisor: Prof. Dr. Edoardo Traversa

Contact: Faculté de Droit Université catholique de Louvain- Place Montesquieu 2 – 1348 Louvain-la-Neuve – Belgium - alice.pirlot@uclouvain.be