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High Court of Justice of autonomous region of Valencia seeks preliminary ruling from Court of Justice of European Union on compliance with European Union law of tax on production value of electricity

Legal flash. Energy and Environment, Finance and Tax

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- The Judicial Review Chamber of the High Court of Justice of the autonomous region of Valencia ("HCJV") seeks a preliminary ruling from the Court of Justice of the European Union ("CJEU") on the compliance with European Union law of the tax on the production value of electricity.
- The HCJV believes that the tax meets the conditions of an "indirect tax;" would be for collection, but not for non-fiscal purposes; would discriminate against the production of energy from renewable sources; and, lastly, would distort the internal energy market and be contrary to free competition.
- The impact that the seeking of the preliminary ruling might have on ongoing proceedings, both in the courts and in the economic and administrative tribunals, must be examined on a case-by-case basis.

1. Background

Since its creation in 2012, the tax on the production value of electricity ("IVPEE" as per the Spanish term *impuesto sobre el valor de la producción de la energía eléctrica*) has generated doubts about its constitutionality and its compatibility with European Union law.

The doubts as to the constitutionality of IVPEE were finally settled by the Spanish Constitutional Court on June 20, 2018, in its ruling 59/2018, which did not admit the unconstitutionality question submitted by the Supreme Court.

After rejecting the unconstitutionality of the tax, doubts continued as to whether the IVPEE regulations (Spanish Act 15/2012, of December 27, on fiscal measures for energy sustainability) were contrary to European Union law.

2. Preliminary ruling

To clarify whether IVPEE is contrary to European Union law, the HCJV, under article 267 of the Treaty on the Functioning of the European Union ("TFEU"), issued on February 22, 2019, a ruling seeking four preliminary rulings on interpretation from the CJEU.

In this ruling, the HCJV states the following reasons to doubt the compatibility of IVPEE with European Union law:

a) Despite its regulation as a direct tax, IVPEE has a nature and meets a set of essential conditions that are proper to an indirect tax.

The HCJV does not accept the alleged direct nature of IVPEE. In its opinion, it is not its true nature, and draws attention to the fact that, for EU law, the classification of a tax as direct or indirect is based on an autonomous notion which, in accordance with CJEU case law, must be established using categories of this transnational legal system depending on the objective characteristics of the tax, resulting from its true nature, and independently from the classification given in national law.

The HCJV refers to CJEU case law in this matter, in which it is stated that one of the main factors to classify a tax as indirect or not is whether the economic burden of the tax, even if not formally passed on, can be economically transferred to consumers.

Based on this conceptualization, the HCJV considers, among other factors, the fact that IVPEE:

(i) has a tax base that is not constituted by net income but by the gross income from the production of electricity or its incorporation in the system;

(ii) has a unique (7%) tax rate, as is proper to indirect taxes;

(iii) lacks the gradualness inherent to direct taxes; and

(iv) does not consider any of the subjective circumstances of the taxpayer whose activity is taxed. All these characteristics indicate, in the HCJV's view, that it is an indirect tax.

It also states that, although there is no formal mechanism to pass on IVPEE, the tax burden is transferred to the final consumer through the price. The ruling states that, since IVPEE was implemented, the price of the electricity bill for all end consumers has increased. This was demonstrated in the recent approval of Royal Decree Law 15/2018, of October 5, establishing a transitional exemption in the implementation of IVPEE, which exempts energy producers from paying it for six months (those months when the price reaches its annual maximum levels), with the declared intention of lowering consumers' electricity bills.

To conclude, according to the HCJV, IVPEE has the characteristics proper to an indirect tax on consumption.

b) Despite allegedly having an environmental purpose, IVPEE is essentially a tax with no specific purpose, intended for collection, not for non-fiscal purposes.

In the ruling seeking the preliminary ruling, it is reflected that the taxable event is not connected to the environmental goal, and there is no distinction based on the environmental impact of the technology employed.

It is also stated that the proceeds from the collection of IVPEE are not intended for environmental purposes, but to finance the electricity system costs—what is known as the "tariff deficit." Therefore, the ruling concludes that the tax has solely collection purposes, and lacks the non-fiscal purpose established by regulations.

Thus, the HCJV concludes that IVPEE, an indirect tax with no specific purpose other than collection, is contrary to article 1.2 of Directive 200/118/EC of December 16, 2008, concerning the general arrangements for excise duty, as this directive allows the establishment of indirect taxes on products already taxed by a harmonized tax (such as electricity), but only to the extent that those taxes have a specific purpose other than merely a collection purpose.

The ruling establishes an interesting parallelism between IVPEE and the special tax on retail sales of certain hydrocarbons (what was known as the "healthcare cent"), a tax that was

declared by the CJEU to be incompatible with European Union law (CJEU Judgments of 27/2/2014, case C-82-12, Transportes Jordi Besora).

c) IVPEE would discriminate against the production of energy from renewable sources.

In the same way, the ruling warns about the potential incompatibility of IVPEE with Directive 2009/28/EC of April 23, 2009, establishing that EU Member States must reach mandatory national targets regarding the share of energy from renewable sources in the gross final consumption of energy by 2020.

In the HCJV's view, the blurred environmental purpose of IVPEE discourages the generation of electricity from renewable sources, as it is a tax that is not proportional to costs, as it is calculated based on a fixed percentage of gross income, without complying with the polluter pays principle established in article 191.2 TFEU.

The order also states that Directive 2009/28/EC establishes a principle under which the development of the industry for the production of electricity from renewable sources cannot be damaged by "non-proportional taxes."

To conclude, according to the HCJV, a harmonizing regulation such as Directive 2009/28/EC, which seeks to encourage the use of energy from renewable sources, can be breached by a tax such as IVPEE, which indiscriminately taxes all technologies equally, regardless of their environmental impact.

d) IVPEE would distort the interior energy market and be contrary to free competition.

Lastly, the HCJV considers that the IVPEE regulation discriminates in favor of non-national electricity producers, as it taxes the inclusion in the electricity system of electricity produced in the Spanish market, while imported energy is not subject to this tax, as article 110 TFEU prevents it, thus distorting free competition in a manner prohibited by article 107.1 TFEU.

In the HCJV's view, the establishment of a competitive advantage in favor of non-national producers, who are not subject to IVPEE, alters the free circulation of goods, freedom of establishment, and the free provision of services, and may breach Directive 2009/72/EC, which regulates third-party access to the electricity transport and distribution network in an objective and non-discriminatory manner.

Now that the well-based doubts of the Valencia court have been presented, it is for the CJEU to give the preliminary rulings on IVPEE's compliance with these EU directives.

3. Effect on ongoing proceedings

Regarding the immediate procedural effects of the ruling examined, seeking preliminary rulings from the CJEU will lead to the suspension of all the economic and administrative proceedings being conducted in line with article 237.3 of Spanish Act 58/2003 of December 17, on General Taxation (General Taxation Act). However, this does not mean that the corresponding applications for the rectification of IVPEE self-assessments should not continue to be submitted, requesting the return of undue income, to prevent the right to apply for and obtain those returns from becoming time-barred (article 66 General Taxation Act).

Regarding IVPEE proceedings already being processed in court, we highlight that, although this is not a clear matter or a matter of consensus, the fact is that no law bans a national judge from suspending proceedings being conducted before them when the preliminary ruling requested from the CJEU may be crucial for the decision reached in the proceedings.

There are antecedents in civil law, such as judgment 2027/2016 given on April 12, 2016 by the Civil Chamber of the Supreme Court (ECLI:ES:TS:2016:2927A), which suspended proceedings regarding the invalidity of a floor clause directly linked to the object of a preliminary ruling to be issued by the CJEU.

In this way, consistently with the suspension of economic and administrative proceedings and, based on the principle of procedural economy, we believe that the suspension of the legal proceedings should be requested, so the national judges can await the CJEU's preliminary ruling to be able to give the parties in the lawsuit the most adequate answer from the point of view of EU law.

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