Sustainability Taxation in 2021

by Deirdre Hogan and Andrew Coster

Global environmental and energy taxes (so-called "Green taxes") are becoming increasingly common as Governments strive to change behaviours that are detrimental to the environment. The introduction of Green taxes is viewed as a key weapon in the fight against climate change as such taxes stand to hurt businesses and individuals alike financially if steps are not taken to reduce their carbon footprint.

Unlike traditional taxes, taking such steps and finding ways to negate the impact of such taxes by means of transitioning to greener alternatives is the driver behind their introduction in the first place and is to be welcomed. In parallel, an unprecedented number of businesses driven not only by their own moral compass but also by consumer demand are establishing energy management and long-term sustainability strategies all of which will have to factor in the increasing taxation of non-climate friendly activities.

The effects of global warming and climate change

The effects of global warming and climate change are becoming more widespread and more costly for Governments, businesses and individuals alike. More frequent extreme weather conditions resulting in flooding, fires, drought, etc. are wreaking havoc on communities, food production, supply chains, animal and human habitats, and increasingly our health and our lives.

Global temperatures in 2021 broke previous records for the hottest June on record in North America, the second hottest in Europe, and the fourth hottest globally.[1]

The speed of climate change is due to the reliance of humans on fossil fuels which emit vast amounts of carbon into the atmosphere as well as activities such as agriculture and deforestation which enhance the detrimental impact of such carbon emissions.

Globally, individual Governments are reacting differently to climate change with some taking the effects more seriously than others.

The European Union (EU) is leading the charge against climate change with its admirably ambitious "Green Deal" which seeks to make Europe the first climate-neutral continent by 2050.[2] Much of the legislation and regulations being enacted at Member State level including Ireland, have been established by the EU. Further revisions and updates to EU regulations including the Energy Tax Directive are expected and will look to introduce additional measures to fight climate change such as the setting of revised carbon emissions target levels across Member States.

1 https://www.nytimes.com/2021/07/07/climate/climate-change-temperatures-june.html
2 https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

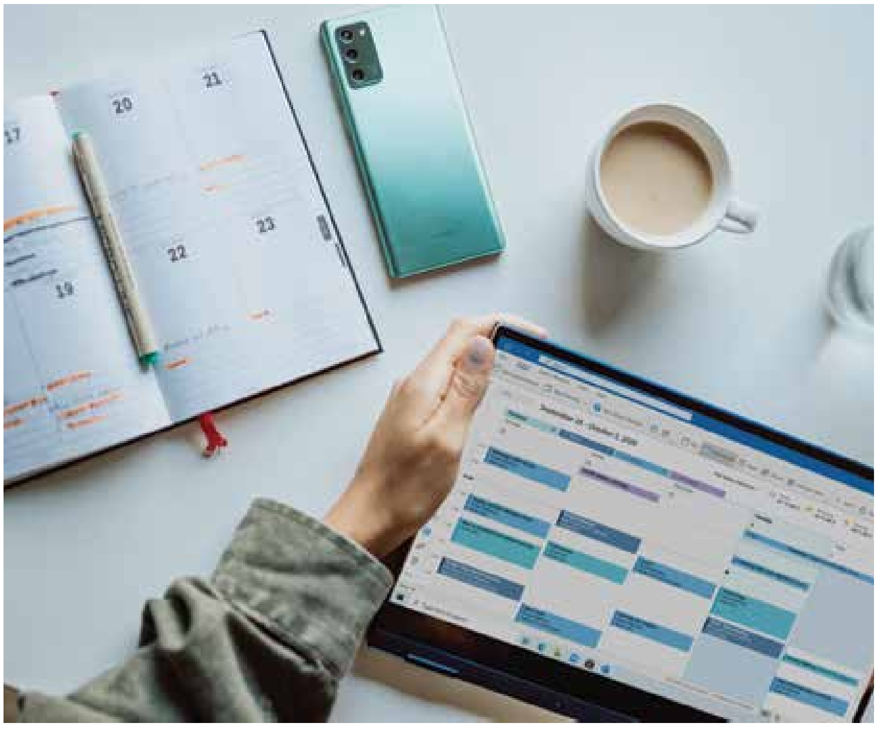
From an Irish perspective, in 2018, Ireland had the third worst emissions of greenhouse gases per capita in the EU at 12.6 tonnes of carbon dioxide per capita while emissions were also 53% higher than the EU28 average of 8.2 tonnes.[3] Emissions reduced slightly in 2019 and fell by a further 5.9% in 2020 (primarily due to the impact of the COVID-19 pandemic)[4]. While going in the right direction, Ireland missed its energy and climate targets for 2020 resulting in significant penalties being imposed by the EU.

Despite its failure to meet current emissions reduction targets, Ireland has been a firm advocate for the fight against climate change. It was the first country in the world to label climate change a national emergency and in 2020 it published the Climate Action and Low Carbon Development (Amendment) Bill 2020. The Bill will set the country on course to become climate neutral by 2050.

As a result, Ireland along with other countries in the EU and indeed globally, are looking to invest heavily in structural and behavioural changes to enable the transition to a climate neutral, climate-resilient economy. These changes generally include the rapid decarbonisation of energy and transport and the adoption of sustainable food production, management and consumption systems to ensure environmental aims and emissions targets are met.

The way forward?

Achieving the ambitions set by the EU and Ireland will require not only significant changes and physical investment in these areas, but also behavioural changes from society, Governments and businesses. While there are many methods to change future behaviours such as through education or legislative amendments, one of the key levers open to Governments is taxation, both as an incentive and a deterrent.



There is clear evidence that taxation can work to change behaviours. One example from an Irish perspective is that of the plastic bag levy which was introduced in Ireland in 2002. It led to a 90% drop in plastic bag usage, with one billion fewer bags used, and it generated $9.6 million for a green fund supporting environmental projects.[5] In addition, there is much less roadside litter from plastic bags. Ironically, with the success of the levy, the revenue take has dropped meaning less money for environmental projects however, the overall aim of changing societal behaviours for environmental good was successful.

Given the impact and speed at which certain taxes can work to change behaviours, it is consistently among the first levers being pulled by Governments to tackle climate change. Alongside the plastic bag levy, (which more and more countries have adopted), other taxes being introduced and applied are energy taxes, transportation taxes and taxes on pollution and resources. Carbon tax in particular is a tax that many countries seem to be adopting in various forms.

The introduction of carbon pricing and "Green" taxation in Ireland and at a European level

As mentioned, reducing carbon emissions is an imperative for the EU/Ireland and understanding the impact of carbon taxes for businesses and individuals is essential. The carbon pricing landscape is constantly changing as pressure is rising on stakeholders to act now.

The Irish Government introduced a carbon tax in 2009 on petrol, diesel, oils and gas, and it was extended to solid fuels (coal and peat) in 2013 and 2014 with the recent 2020 Finance Act allowing for gradual increases in natural gas and solid fuel carbon taxes over the next decade.[6] The rate per tonne of CO2 emissions was increased in the most recent 2021 Budget by €7.50 from €26 to €33.50 per tonne of CO2 emission and the Irish Government has set out its intent to increase the carbon tax to €100 per tonne of CO2 emissions by 2030.[7]

The forecasted increases in the carbon tax rate planned for the next nine years will certainly increase revenues for the Irish exchequer but will undoubtedly

3 https://www.cso.ie/en/releasesandpublications/ep/p-eii/environmentalindicatorsireland2020/greenhousegasesandclimatechange/

4 Adeyanju, G.C., Augustine, T.M., Volkmann, S. et al. Effectiveness of intervention on behaviour change against use of non-biodegradable plastic bags: a systematic review. Discov Sustain 2, 13 (2021).

5 https://www.irishenvironment.com/iepedia/plastic-bag-levy/

6 Section 28 and 29, Finance Act 2020

7 http://budget.gov.ie/Budgets/2021/Documents/Budget/Carbon%20tax%20document.pdf

become a financial burden for both individuals and businesses unless measures are put in place to reduce their carbon footprint by moving to more sustainable energy sources.[8]

The move towards more sustainable energy sources may not only result in lower long-term costs but may also create the opportunity to make savings by the use of the varied "green" incentives, tax reliefs and research & development credits that are available. While taxes are the stick to change behaviours the introduction of incentives (while still relatively limited) are seen as the carrot.

There has been some criticism that certain sectors of society such as those in rural communities could be impacted by the carbon tax more severely than urban dwellers (where for example transportation costs may be higher) therefore it is imperative that any environmental taxes do not unfairly discriminate and that a level societal and economic playing field is maintained.

While carbon tax has a significant role to play, the cornerstone of the EU's policy to combat climate change and reduce greenhouse gas emissions cost effectively is the EU Emissions Trading Scheme (ETS), which operates in all EU countries plus Iceland, Liechtenstein and Norway.[9] The ETS puts a limit on emissions from installations in the power sector, manufacturing industry and airlines operating between the countries mentioned above and covers around 40% of the EU's greenhouse gas emissions.

The EU ETS works on the 'cap and trade' principle setting a cap on the total amount of certain greenhouse gases that can be emitted by the installations covered by the system. A fixed number of allowances which are the currency of the carbon market are issued to the relevant business at the carbon market price. If businesses reduce their emissions, they can keep the spare allowances or sell them. By limiting the total number of allowances available, the EU ensures the allowances have value.

Over time the cap is reduced, fewer allowances are issued, techniques to cut emissions are developed and total greenhouse gas emissions drop.

There has been criticism that the ETS does not go far enough and there have been calls to expand the scheme to include both buildings and road transport in order to make all economic sectors greener. Discussions about increasing the scope of the EU ETS to include other sectors like the buildings and road transport sectors have been earmarked by the EU and aspects of these are expected to be included in revised EU regulations in the short term.

The EU has also sought to protect the competitiveness of EU businesses while maintaining the fight against climate change and ensure that carbon leakage does not occur by announcing the proposed introduction of a Carbon Border Adjustment Mechanism (CBAM). In brief this will be the imposition of a carbon charge on products entering the EU so that there will be a level playing field between European and foreign

8 http://budget.gov.ie/Budgets/2021/Documents/Budget/Carbon%20tax%20document.pdf
9 https://ec.europa.eu/clima/policies/ets_en

manufacturers. The objective, according to the European Commission, is to avoid "carbon leakage" whereby companies relocate abroad in search of lower production costs e.g. lower carbon taxes in this case. The CBAM is expected as of now to come into effect in 2023.

Additional fees and a plastic ban?

From 1 January 2021, EU Member States pay €0.80 for every kilogram of non-recyclable plastic packaging placed on their market which is designed to act as "an incentive for the Member States to reduce these waste streams"[10] and to "foster recycling and boost the circular economy".[11] This tax supplements the EU's own revenue and is paid by EU Member States, based on the amount of non-recyclable plastic packaging waste in each country.

Member States are free to decide how to implement this tax, and while some States have decided to pay the contribution to the EU from their national budget, some, and likely more to come including Ireland, are looking to pass it on to producers in a new form of taxation on plastic packaging products. This is leading to different regimes across the EU.

EU Member States such as Italy and Spain have introduced measures which will apply this tax directly to the plastic producers with effect from 2022. The UK, while no longer part of the EU is also moving ahead with a similar plastic tax also to be introduced in 2022.

However, in Ireland, while the Government has flagged its intent to pass on the tax to producers as of yet no implementing legislation has been proposed.

When such a plastic tax is introduced in Ireland, similar to Spain, Italy and the UK, it is expected that any such measures will significantly impact relevant companies including those in the retail and consumer goods sector, manufacturers of plastic packaging and other industries that use plastic packaging with the additional cost most likely being passed on to the final customer.

In looking at other measures associated with plastic waste, with at least 8 million tonnes of single-use plastics such as bottles and food packaging ending up in our oceans every year[12], the EU has also sought to adopt a Directive[13], commonly referred to as the Single Use Plastics ("SUP") Directive. The objective of this Directive is to prevent and reduce the impact of certain plastic products on the environment, in particular the aquatic environment, and on human health, as well as to promote the transition to a circular economy.

This SUP Directive requires a ban or limitation on the sale of certain SUP items on the EU market (e.g. cotton buds, straws, plates, cutlery, cigarette butts, etc.). Member States are required to incorporate this ban into national legislation from 3 July 2021.

Ireland will comply with the Directive by ensuring that certain SUP items will be banned from being placed on the Irish market with rolling implementation dates from 3 July 2021[14].

These SUP items include cotton bud sticks; cutlery; plates; stirrers; chopsticks; straws; expanded polystyrene single use food and beverage containers; and all oxo-degradable plastic products.

The Irish Government have also set out further SUP restrictions within the next few years, these include: By 5 January 2023, producers of packaging will be required to cover the costs of litter clean up; and

- By 5 January 2023, producers of tobacco products which contain plastic will be subject to the Extended Producer Responsibility ("EPR") scheme which ensures that producers maintain both a financial and physical responsibility for certain goods even in the post-consumer phase of their lifespan.

Producers of balloons, wet wipes and fishing gear will also have to comply with the EPR scheme by 31 December 2024;

- From 3 July 2024 beverage containers (bottles, cartons) up to three litres in size will be banned from the Irish market, unless its cap is attached to the main part of the container.

The 'Plastics ban' has far reaching consequences for any business that produces SUP and/or uses SUP in its supply chain. As more developments and guidance are expected on the application of the SUP Directive it is important to keep abreast of any developments as the SUP Directive is introduced across the EU.

What we're currently seeing in the market

Measures to combat climate change are regarded by many businesses as an opportunity to make cost reductions whether it be by reducing energy, plastics packaging and transport usage by moving towards a low carbon sustainable business model. Some examples of corporations moving towards increasingly sustainable futures include:

- H&M, who have established second-hand clothing schemes and take-back programmes along with many other large clothing retailers.
- Large multinational corporations such as Amazon have been building wind farms and are seeking to use the excess heat from their data centres to power towns through local Heating Systems.
- Drinks manufacturer Coca Cola have stated that 100% of the water they use to produce their beverages is replenished.

10 European Commission (2018), Staff Working Document SWD (2018) 172 of 2 May 2018, Financing the EU budget: report on the operation of the own resources system, p. 27.

11 Council of the European Union (2020), Proposal ST 10025 2020 INIT of the Presidency of 29 July 2020 for a Council Decision on the system of Own Resources of the European Union, p. 4, recital 7.

12 https://www.iucn.org/resources/issues-briefs/marine-plastics

13 Directive (EU) 2019/04: EUR-Lex - 32019L0904 - EN - EUR-Lex (europa.eu)

14 Department of the Environment, Climate and Communications - Single-use Plastics: gov.ie - Single-use Plastics (www.gov.ie)

While the above examples focus mainly on the efforts of multinational corporations to improve their sustainability and reduce taxation costs, many smaller businesses can look to follow a similar path and future proof their business especially those industries that will be most affected by the taxation changes such as transportation services and manufacturing.

The Irish Government has provided a series of initiatives and financial supports for businesses seeking to "go green". Some of these initiatives include: the Climate Enterprise Action Fund[15] to aid businesses in their sustainability planning, support schemes for renewable heat, sustainability training for smaller businesses through the Green for Micro programme[16] and the Accelerated Tax Allowance tax incentive scheme allowing tax-compliant Irish businesses to deduct the full cost of energy-efficient equipment from their profits in the year of purchase[17].

How businesses can adapt to the new sustainability taxes

Firstly, businesses need to identify the risks that climate change and sustainability taxation will have on their cost base and the future of their business.

Businesses need to determine whether and to what extent policy and tax legislation developments impact their operations, through policy and tax analysis, forecasts and assessments, such as carbon modelling, while also ensuring their business is compliant with plastic tax and other requirements.

Second, businesses should know and understand the risk that environmental taxation trends could have on the business. For example, increases in the carbon tax in Ireland as projected could put greater financial strain on the business in particular those in the transport sector.

Finally, businesses should mitigate their risk and use the environmental changes to create opportunities within the marketplace. By taking action to reduce the risk associated with new taxes, businesses can seek to create further opportunity.

Companies can for example, use the recent tax incentives in Ireland for electric cars, energy efficiency projects and retraining schemes to encourage behavioural change and help transition to a sustainable future while also maintaining a resilient business model. If they fail to do this, they risk being left behind as Governments, global organisations and consumers demand they make that switch sooner rather than later to protect the planet and ourselves.

Deirdre Hogan,

Partner, Indirect Tax,
Ernst & Young Ireland.

Deirdre leads the Indirect Tax team at EY Ireland and has 16 years of experience in providing tax technical and advisory services to clients worldwide. Deirdre is also the Sustainability Tax lead for EY Ireland.

Andrew Coster,

Indirect Tax Assistant,
Ernst & Young Ireland.

Andrew is part of the Indirect Tax team at EY Ireland. He engages in various indirect tax matters including compliance, advisory, tax technology and sustainability taxation issues.

15 https://globalambition.ie/climate-enterprise-action-fund/
16 https://www.localenterprise.ie/Green/What-is-Green-for-Micro/What-is-Green-For-Micro.html
17 https://www.seai.ie/business-and-public-sector/business-grants-and-supports/accelerated-capital-allowance/