ASSET

Accounting for Sustainability,
Social and Environmental Transparency

GLOSSARY
TEACHING MODULE 4

Sustainability, taxation and strategic decision making

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GLOSSARY

Sustainability, taxation and strategic decision making

1. Carbon pricing
A mechanism that places a monetary cost on carbon emissions to encourage polluters to reduce their greenhouse gas emissions. It includes carbon taxes and cap-and-trade systems.

2. Cap-and-Trade System
A market-based approach to controlling pollution by providing economic incentives for reducing emissions. Companies are given a cap on emissions and can trade permits or credits if they exceed or fall below their allowance.

3. Carbon Border Adjustment Mechanism (CBAM) – represents a *policy* framework developed by the European Union (EU) aimed at addressing *carbon leakage and promoting fair competition*. It is part of the EU's broader climate strategy, particularly the European Green Deal.
The policy imposes a *carbon price on imports of certain goods* (*e.g. sectors covered: cement, iron & steel, aluminium, fertilisers, electricity, hydrogen*) from countries outside the EU that do not have equivalent carbon pricing mechanisms. CBAM includes mechanisms for calculating and imposing these carbon costs on imports, encouraging both EU and non-EU producers to adopt greener production methods and aligns with the EU's Emissions Trading System (ETS), ensuring imported goods face the same carbon costs as those produced within the EU.
The term "CBAM" itself refers to the entire policy initiative, aimed at leveling the playing field for European companies by ensuring that imported goods reflect their carbon footprint in their pricing, thus encouraging global climate action.
To find more detailed information, you can explore the following links: https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en, https://trade.ec.europa.eu/access-to-markets/en/news/carbon-border-adjustment-mechanism-cbam.

4. Circular economy and waste taxation
This concept is part of the Circular Economy Action Plan, encouraging member states to use taxation to promote the reuse, recycling, and repair of products. Taxation on raw materials and waste is used to make circular practices more economically attractive. These taxes aim to reduce the environmental footprint of production and consumption by making waste disposal more costly and recycling more financially viable.

5. Ecological Fiscal Reform (EFR)
A set of policies aimed at reforming the tax system to better align economic incentives with environmental goals. This typically involves shifting the tax burden from labor to environmental pollutants or resource extraction.

6. Energy Taxation Directive (ETD) - is a directive under the European Green Deal that updates the taxation of energy products and electricity to better reflect their environmental impact.

It aims to shift taxes from labor to pollution, promoting cleaner energy use. Originally adopted in 2003, the Directive was supposed to several revisions, the main changes reffering to:

- **Minimum tax rates**: Introduces minimum tax rates for energy products based on their environmental performance.
- **Fossil fuel subsidies**: Gradually phases out tax exemptions for fossil fuels, aligning taxation with the carbon content of energy sources.
- **Encouragement of renewables**: Implements lower tax rates for renewable energy sources and electricity to promote their use.

Review of the Energy Taxation Directive (Proposal)

In July 2021, as part of the "Fit for 55" package, the European Commission proposed revising the Energy Taxation Directive (ETD) to better align with EU energy and climate goals, including those of the European Green Deal. This proposal aims to more accurately reflect the climate impact of energy sources and encourage changes in consumer and business behavior, having as key objectives to:

- **Align energy taxation**: Adjust taxes on energy products and electricity to support EU climate policies and meet the 2030 and 2050 climate targets.
- **Preserve the internal market**: Update tax structures and exemptions to maintain the integrity of the EU internal market.
- **Maintain revenue**: Ensure Member States can continue to generate revenue through energy taxation.

The proposal includes new minimum tax rates based on environmental performance, phases out fossil fuel subsidies, and encourages the use of renewable energy by applying lower tax rates. The proposal is currently under discussion by EU Member States.

To find more detailed information, you can explore the following link: https://taxation-customs.ec.europa.eu/taxation/excise-duties/review-energy-taxation-directive-proposal_en

7. EU Taxonomy (Sustainable Finance Taxonomy)

The EU Taxonomy is a classification system that defines environmentally sustainable economic activities. It provides clear criteria for identifying which investments are environmentally sustainable.

Impact on taxation: The EU Taxonomy guides the development of tax incentives for green investments, such as lower corporate tax rates or tax credits for activities that meet the taxonomy's criteria. It plays a crucial role in guiding investments toward greener options, including the development of tax incentives to encourage such investments. Below you can find some examples of tax incentives related to green investments under the EU Taxonomy:

- **Lower corporate tax rates:** Reduced tax rates on the profits of companies that engage in environmentally sustainable activities (e.g. A country might offer a reduced corporate tax rate for companies that derive a certain percentage of their revenue from renewable energy projects, energy-efficient buildings, or other activities aligned with the EU Taxonomy).
- **Tax credits**: Direct reductions in the amount of tax a company owes, based on its investment in environmentally sustainable projects (e.g. A government might provide a tax credit equal to a percentage of the cost of investing in renewable energy infrastructure, such as solar panels or wind farms, if these investments meet the criteria set out in the EU Taxonomy).
- **Accelerated depreciation**: Allows companies to write off the cost of green investments more quickly than other investments, reducing taxable income in the short term (e.g. Companies investing in energy-efficient technologies or electric vehicles could benefit from

accelerated depreciation, meaning they can deduct the investment cost from their taxable income at a faster rate, improving cash flow and incentivizing further green investments).

- **Exemptions and reduced rates on environmental taxes:** Companies engaged in sustainable activities may be exempt from certain environmental taxes or pay them at a reduced rate (e.g. A business that generates power from renewable sources might be exempt from carbon taxes or benefit from reduced rates on taxes related to pollution or resource extraction).
- **Investment allowances**: Deductions from taxable income based on the amount invested in eligible green projects (e.g. A company could deduct a significant portion of its investment in energy-efficient buildings from its taxable income, encouraging more such investments).

These incentives, guided by the EU Taxonomy, aim to direct more capital toward sustainable projects by making green investments financially attractive. The goal is to shift the economy toward more environmentally friendly practices, helping the EU achieve its climate goals. By clearly defining what constitutes a "green" activity, the EU Taxonomy ensures that these tax incentives are applied consistently and effectively across member states.
To find more detailed information, you can explore the following link: https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en

8. Environmental impact fee

A fee imposed on activities or products that cause environmental harm. The revenue generated is typically used to fund environmental protection or restoration projects.

9. Environmental Tax Reforms (ETR)

ETRs are promoted under the European Green Deal to encourage EU member states to design tax systems that support environmental objectives. This includes imposing higher taxes on pollution and resource use, and reducing taxes on income and labor. **Examples of ETRs**:

- **Carbon taxes**: Taxes on greenhouse gas emissions beyond those covered by the ETS, incentivizing reductions in carbon output.
- **Plastic taxes**: Taxes on the production or use of certain plastics to reduce waste and promote recycling.
- **Waste management levies**: Taxes on landfill use and incineration to discourage waste disposal and encourage recycling.

10. Green investments: are financial investments made in projects, companies, or funds that focus on environmentally sustainable activities. These investments aim to generate a positive environmental impact, such as reducing carbon emissions, promoting renewable energy, conserving natural resources, or improving energy efficiency. Green investments align with the broader goals of sustainability, combating climate change, and promoting ecological health. Examples of green investments:

- **Renewable energy projects**: Investing in wind farms, solar power plants, or hydropower projects. These investments contribute to the generation of clean, renewable energy, reducing reliance on fossil fuels and lowering greenhouse gas emissions.
- **Energy-efficient technologies**: Funding companies that develop and manufacture energy-efficient appliances, lighting, or building materials. This includes investments in smart grid technology or energy storage solutions that enhance the efficiency of energy use.

- **Sustainable agriculture**: Investing in companies or projects that focus on organic farming, sustainable forestry, or aquaculture. These practices promote biodiversity, soil health, and water conservation, reducing the environmental impact of food production.
- **Green bonds**: Purchasing green bonds issued by governments or corporations. The proceeds from these bonds are earmarked for projects that have environmental benefits, such as reforestation, clean water initiatives, or sustainable infrastructure.
- **Electric vehicles and public transportation**: Investing in companies that manufacture electric vehicles (EVs) or in public transportation infrastructure, such as electric buses or rail systems. These investments help reduce emissions from the transportation sector and promote cleaner alternatives to conventional vehicles.
- **Waste management and recycling**: Funding companies that develop innovative recycling technologies or waste-to-energy plants. These investments help manage waste sustainably, reduce landfill use, and recover valuable resources.
- **Sustainable real estate**: Investing in real estate projects that meet green building standards, such as LEED (Leadership in Energy and Environmental Design) certification. These buildings are designed to be energy-efficient, use sustainable materials, and minimize their environmental footprint.

11. Green VAT (Value-Added Tax) adjustments

Green VAT adjustments are proposals under the Green Deal to modify VAT rates to promote environmentally friendly products and services. This could include reduced VAT rates for products with a lower environmental impact, like energy-efficient appliances and sustainable building materials. The Green VAT's objective is to encourage consumers to choose greener products by making them more affordable compared to less sustainable alternatives.

12. Greenwashing

Greenwashing is the act of giving a false impression or providing misleading information about how a company's products are more environmentally sound than they actually are. It's a marketing tactic used to attract environmentally conscious consumers without making substantial, verifiable changes to sustainability practices. Greenwashing can erode consumer trust, hinder genuine sustainability efforts, and create confusion in the marketplace. It can also lead to regulatory scrutiny and potential penalties for deceptive advertising.

While greenwashing is primarily an issue of corporate ethics and consumer protection, it can intersect with taxation in the following ways:

- **Tax incentives and greenwashing**: Companies might falsely claim to be engaged in environmentally friendly practices to qualify for tax breaks or incentives designed for sustainable activities.
- **Regulatory oversight**: Governments may need to ensure that tax benefits tied to sustainability are only granted to companies that can substantiate their claims of being environmentally friendly, preventing the misuse of such incentives through greenwashing.

Although greenwashing itself isn't a tax-related concept, it becomes relevant in the context of how businesses might misuse tax incentives aimed at promoting genuine sustainability.

13. Greenhouse Gas (GHG) Tax

A tax specifically targeting emissions of greenhouse gases other than carbon dioxide, such as methane or nitrous oxide, to reduce their impact on climate change.

14. Polluter Pays Principle (PPP)

A principle where those who produce pollution bear the costs of managing it to prevent damage to human health or the environment. It's a foundational concept in environmental taxation, ensuring that the cost of environmental harm is internalized by the polluter.

15. Revenue recycling

The practice of using revenue generated from environmental taxes, such as carbon taxes, to fund further green initiatives. This can include investments in renewable energy projects, public transportation improvements, or subsidies for green technologies. The revenue recycling's purpose is to ensure that environmental taxes contribute directly to the goals of the Green Deal, creating a virtuous cycle of reinvestment in sustainability.

16. Resource Extraction Tax

A tax imposed on the extraction of natural resources, such as minerals, fossil fuels, or timber, intended to reflect the environmental cost of resource depletion and encourage more sustainable use of natural resources.

17. Tax incentives for green investments: Various tax incentives are designed to encourage green investments by businesses and individuals.

These incentives often come in the form of reduced tax rates, tax credits, exemptions, or deductions. The primary goal is to stimulate investment, boost economic development, or promote socially beneficial activities, such as renewable energy adoption or job creation. Examples of tax incentives:

- **Tax credits**: A direct reduction in the amount of tax owed by an individual or company, often provided as a reward for engaging in specific activities.
  Example: The **French Tax Credit for Energy Transition (CITE)** is a tax credit offered to homeowners who invest in energy-efficient home improvements. This program allows individuals to deduct a percentage of the costs associated with installing energy-efficient systems, such as insulation, high-efficiency boilers, or renewable energy equipment like solar panels, from their income tax. This incentive aims to encourage the adoption of energy-saving measures and reduce overall energy consumption in residential buildings across France.
- **Tax deductions**: Amounts that can be subtracted from a taxpayer's gross income, reducing the taxable income and, consequently, the amount of tax owed.
  Example: In **Germany**, businesses can benefit from **deductions for investments in energy-efficient technologies** under the " Energy Efficiency Networks Initiative" (EENI). Companies can deduct a portion of their investments in energy-saving technologies and equipment, such as high-efficiency heating systems or advanced energy management systems, from their taxable income. This deduction aims to encourage businesses to improve their energy efficiency and reduce their carbon footprint. By lowering the taxable income, the deduction reduces the overall tax liability for companies investing in green technologies.
- **Tax exemptions**: Complete or partial relief from paying certain taxes, often granted to encourage specific activities or support particular groups.
  Example: **In Italy, the "Ecobonus" program** provides tax exemptions for investments in energy efficiency improvements in residential buildings. Homeowners who invest in energy-saving upgrades such as insulation, efficient heating systems, and solar panels can benefit from significant tax deductions and exemptions. Under this program, eligible expenses can be deducted from personal income tax, effectively reducing the amount of tax owed. This

exemption encourages individuals to invest in energy-efficient home improvements, promoting greater environmental sustainability and energy conservation.

- **Reduced Tax Rates**: Lower tax rates applied to certain types of income, investments, or businesses to promote specific sectors or activities.
  Example: **Dutch Green Investment Deduction Scheme (MIA/Vamil)** in the Netherlands. This scheme provides substantial tax incentives to businesses that invest in environmentally friendly technologies and sustainable projects. According to **MIA (Milieu-investeringsaftrek - Environmental Investment Deduction)** businesses can deduct up to 36% of the investment costs for qualifying environmentally friendly assets from their taxable profits. The scheme covers a wide range of green investments, including renewable energy technologies, energy-efficient equipment, sustainable buildings, and pollution control devices. To qualify, investments must be listed on the annually updated Environmental List (Milieulijst), and businesses must apply within three months of committing to the investment.
- **Accelerated depreciation**: Allows businesses to write off the cost of an asset more quickly than the standard depreciation schedule, leading to reduced taxable income in the short term.
  Example: In the Netherlands **Vamil (Willekeurige afschrijving milieu-investeringen - Random Depreciation of Environmental Investments)** scheme offers d**epreciation flexibility**: This allows businesses to depreciate 75% of the investment costs for green assets at a rate and time of their choosing, providing significant cash flow benefits and tax relief.
- **Investment allowances**: Additional deductions from taxable income based on the amount invested in certain types of assets or projects.
  Example: The **Enhanced Capital Allowances (ECA) scheme** in the United Kingdom allowed businesses to claim additional deductions from their taxable income based on investments in certain types of energy-efficient and environmentally beneficial assets. Enhanced Capital Allowances provided an additional deduction from taxable income based on the amount invested in qualifying energy-efficient and water-saving technologies. The scheme aimed to encourage businesses to invest in environmentally friendly technologies by offering significant tax relief. The scheme covered a range of energy-efficient and environmentally beneficial technologies listed on the Energy Technology List (ETL) and Water Technology List (WTL), including items such as high-efficiency boilers, energy-saving lighting, and water-efficient equipment. The scheme provides 1**00% first-year allowance**: Under the ECA scheme, businesses could claim a 100% first-year allowance on their qualifying capital expenditure. This meant that they could deduct the full cost of the investment from their taxable income in the year the investment was made. Although the ECA scheme was replaced by the Structures and Buildings Allowance (SBA) in 2020, its impact during its operational years serves as a testament to the effectiveness of such tax incentives.

18. The EU's Emissions Trading System (ETS) is a cornerstone of the European Union's policy to combat climate change and a key tool for reducing greenhouse gas emissions cost-effectively. It operates on a "cap and trade" principle, where a cap is set on the total amount of certain greenhouse gases that can be emitted by installations covered by the system. Within this cap, companies receive or buy emission allowances, which they can trade with one another as needed. The cap is reduced over time, so total emissions fall. The ETS key feature is the **Cap and Trade System**: A cap is set on emissions, and allowances are allocated or auctioned to companies. Companies can trade these allowances to meet their needs. ETS covers sectors like power

generation, manufacturing, and aviation within the EU and its goal is to incentivize companies to reduce their emissions and invest in cleaner technologies.
You can find more information about the EU's Emissions Trading System on the official website of the European Commission: https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets_en.