Climate change levy: removal of exemption for electricity from renewable sources

Who is likely to be affected?
Generators of renewable source electricity (RSE), energy market participants and suppliers of such electricity to business or public sector consumers.

General description of the measure
This measure removes the exemption from the climate change levy (CCL) for RSE which is supplied to business or public sector consumers under the terms of a renewable source contract.

There will be a transitional period from 1 August 2015, during which electricity suppliers will be able to continue to exempt RSE generated before that date. This will be permitted if they hold sufficient renewable levy exemption certificates (LECs) that relate to that electricity and use them against supplies they make to eligible consumers. The length of this transition period will be discussed with regulators and affected businesses over the summer and autumn.

Policy objective
Renewable electricity has been exempt from the CCL since its introduction in 2001. The tax is not paid on renewable electricity supplied to businesses and the public sector under renewable source contracts.

Since the exemption was introduced, more effective policies have been put in place to support renewable electricity generation. These target support directly at renewable generators, whilst the CCL exemption seeks to support renewable generation indirectly through stimulating demand. In 2015-16 alone the support for low carbon generators will be around £4.3 billion.

The government is committed to meeting its climate change objectives in a cost effective way. Without action the exemption would cost £3.9bn over this Parliament and one third of this value would go to supporting renewable electricity generated overseas. This electricity would not contribute to the UK’s climate change or renewable energy targets. There is evidence that some of the suppliers receiving the exemption are already in receipt of subsidies in their own country. This does not represent good value for money.

In addition the value of the exemption going to support UK renewable generators is likely be negligible by the early 2020s, when the supply of renewable electricity will exceed CCL eligible business demand for it. As a result it is hard for generators to factor the exemption into their long term investment plans.

Removing the exemption will stabilise CCL revenues, contributing to fiscal consolidation. It will maintain the price signal necessary to incentivise energy efficiency. It will also bring a significant simplification to CCL.
Background to the measure

The CCL was introduced in 2001, to improve industrial and commercial energy efficiency and so reduce greenhouse gas emissions. It is a UK-wide tax on the supply of energy to businesses and the public sector, with separate rates for electricity, gas, solid fuels and liquefied gases depending on their energy content.

The CCL exemption for RSE was introduced from the start of the CCL, to increase demand for renewables from business consumers and so support the renewable generation sector. It works by UK suppliers acquiring electricity generated from renewable sources (whether domestically or overseas) and supplying it to business customers, with whom they must hold a contract that contains a renewable source declaration. These contracts are referred to in HMRC and Ofgem guidance as ‘renewable source contracts’.

The acquisition of RSE, and the allocation of it to an eligible business supply, is evidenced by LECs. The electricity regulators - Ofgem (for Great Britain) or the Northern Ireland Authority for Utility Regulation (NIAUR) (for Northern Ireland) - issue LECs to renewable generators, with one LEC representing one megawatt of renewable electricity generated. Generators then sell their renewable electricity, along with the accompanying LECs, to suppliers, who supply the renewable electricity to an eligible business customer and apply the CCL exemption to their customer’s bill. Electricity suppliers must then redeem the LEC with the relevant regulator.

Detailed proposal

Operative date

With effect from midnight on 31 July 2015, electricity generated from renewable sources will no longer be eligible for the CCL exemption for RSE when supplied under a renewable source contract.

Electricity utilities that have accumulated RSE and renewable LECs relating to RSE that was generated before 1 August 2015 may continue to allocate these to renewable source contracts for a transitional period commencing on 1 August 2015. Such supplies can be exempted from CCL.

Current law

The exemption from CCL for supplies of renewable electricity is contained in paragraph 19 of Schedule 6 to the Finance Act 2000 (‘Schedule 6’).

To cater for variations in supply of and demand for RSE, paragraph 20 of Schedule 6 enables electricity utilities to match the acquisition of RSE with supplies that are exempt from CCL because they were made under the terms of a contract that contains a renewable source declaration. The matching is carried out over quarterly periods and allows the carry forward of credit and debit balances.

The administrative provisions for the exemption are set out in Part IV of the CCL (General) Regulations 2001. For example, Regulation 48 determines that in order for electricity to be considered to be RSE for the purposes of paragraphs 19 and 20 of Schedule 6, it must be the subject of a LEC.
Proposed revisions

Legislation will be introduced in Summer Finance Bill 2015 to amend paragraph 19 of Schedule 6 to the Finance Act 2000 so that any RSE generated on or after 1 August 2015 is no longer eligible for the RSE exemption for CCL when supplied under the terms of a renewable source contract.

Where an electricity utility has a credit balance at 1 August 2015 relative to the provisions of paragraph 20 of Schedule 6, it will be able to continue to make CCL exempt supplies under either existing or new renewable source contracts until the transitional arrangements end or their credit balance is used up, whichever is sooner. Where it has a debit balance at 1 August 2015, the utility will either have to acquire RSE generated before that date in order to continue to make exempt supplies in respect of its renewable source contracts, or it will have to make payment to HMRC to account for the deficit due at the end of the relevant averaging period.

Summary of impacts

<table>
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<tr>
<th>Exchequer impact (£m)</th>
<th>2015-16</th>
<th>2016-17</th>
<th>2017-18</th>
<th>2018-19</th>
<th>2019-20</th>
<th>2020-21</th>
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<tbody>
<tr>
<td></td>
<td>+450</td>
<td>+490</td>
<td>+575</td>
<td>+685</td>
<td>+800</td>
<td>+910</td>
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These figures are set out in Table 2.1 of Summer Budget 2015 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Summer Budget 2015.

Economic impact

This measure is not expected to have any significant macroeconomic impacts.

The costing includes a behavioural effect to account for suppliers adjusting to the new tax regime.

Impact on individuals, households and families

As CCL is not chargeable on supplies of electricity to individuals and households, the change should not impact on or increase domestic electricity bills.

The measure is not expected to impact on family formation, stability or breakdown.

Equalities impacts

The proposed changes will affect businesses and public sector consumers that contract for a supply of RSE. There will be no direct impact on individuals. As such, there will be no differential impact on different equality groups.

Impact on business including civil society organisations

The measure is expected to have a negligible administrative impact on businesses and civil society organisations.

Electricity suppliers will, after the transitional period, have to start accounting for CCL on RSE supplies to business and public sector consumers. This will result in a negligible continuing saving for them in calculating tax liability as they will no longer have to deduct RSE.
There will be a negligible one-off cost as suppliers will need to make changes to their administrative systems to apply CCL at the main rate when the exemption runs out. We expect there are no suppliers who will have to register for CCL as a result of this measure but if there are this will result in a negligible one off cost.

Removing the exemption is not expected to impact on wholesale electricity prices.

As the business energy market is highly competitive, removing the exemption is not expected to significantly increase business energy bills. Energy intensive industries can already exempt themselves from 90% of CCL costs by signing Climate Change Agreements.

Renewable generators overseas who export electricity to the UK will cease to benefit from the exemption.

Renewable generators in the UK could be impacted by the change in the short-term. However the value they receive from the exemption is expected to be negligible by the early 2020s. Any short-term loss will be minimal compared with the support expected to be allocated to renewable generators in 2015-16 alone.

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<th>Operational impact (£m) (HMRC or other)</th>
<th>Changes in HMRC costs are estimated to be negligible and would fall as part of the existing operational cost of administering CCL. The government will consult Ofgem and NIAUR over summer/autumn 2015 to establish the costs and other impacts on the regulators of removing the exemption.</th>
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| Other impacts | Environmental impact: this will maintain the price signal for incentivising energy efficiency. The measure will have no direct impact on the achievement of UK Carbon Budget targets, as emissions from electricity generation are capped through the EU Emissions Trading System. The measure is not expected to impact on the UK's renewable energy target. The government is on track to meet its ambition for at least 30% of electricity demand to be met by renewable sources. Other impacts have been considered and none have been identified. |

**Monitoring and evaluation**

The measure will be kept under review through regular communication with taxpayer groups affected by the measure. HMRC will also work closely with Ofgem and NIAUR to monitor the redemption of renewable LEC holdings.

**Further advice**

If you have any questions about this change, please contact Tim Smith on 03000 585475 (email: timothy.smith@hmrc.gsi.gov.uk) or contact Viki Moore on 03000 587920 (email: viki.moore@hmrc.gsi.gov.uk)