HM Treasury consultation: reforming the business energy efficiency tax landscape - Energy Institute response

- The Energy Institute (EI) welcomes the opportunity to make the following submission to HM Treasury towards their consultation on the business energy efficiency policy landscape.
- This document is a synthesis of the views of EI members collected through a call for contributions, focusing on a limited set of the questions posed by HMT. The shortened questionnaire was sent by email to 500 EI Fellows, Members, and Graduates from across sectors and disciplines. Additionally it was sent to 45 selected stakeholders in the energy management roles, including members of our Register of Professional Energy Consultants and Chartered Energy Managers. In total we received 100 responses, with about 50 detailed written responses on average to each question. The views expressed in this document are not those of the EI as an organisation, but of our members who participated in this exercise.
- In January 2016 we will also hold a workshop for this stakeholder group.
- The EI is the leading chartered professional membership body for the global energy industry, supporting over 23,000 individuals working in or studying energy and 200 energy companies worldwide. The EI provides learning and networking opportunities to support professional development, professional recognition and technical and scientific knowledge resources on energy in all its forms and applications. The purpose of the EI is to develop and disseminate knowledge, skills and good practice towards a safe, secure and sustainable energy system. A registered charity, it serves society with independence, professionalism and a wealth of expertise in energy matters.

Summary of responses

1. Do you agree with the principle of moving away from the current system of overlapping policies towards a system where a single business/organisation faces one tax and one reporting scheme? Please provide evidence on level and types of benefits of an approach like this.

EI members overwhelmingly respond 'Yes,' however the devil is in the detail.

Commonly cited benefits of clear, simple policies are the reduction of administrative and financial burden and increased compliance. Several members emphasised that SMEs may not have the expertise or resources (both human and financial) to report accurately to multiple schemes. Harmonising the objectives of schemes and streamlining the reporting mechanisms, without duplicating work across schemes because of nuances or conflicts in the data to be collected (e.g., energy v carbon, units of measure, reporting period, etc.) is seen as important.

A unified approach would give a clearer and more easily decipherable view of energy performance both to businesses and government. It would allow organisations to engage more meaningfully with their own energy objectives through greater visibility at board level and easier understanding by ‘non-energy’ stakeholders.

It was also noted that multiple policy objectives will be difficult to wrap up under a single mechanism without compromising strategic effectiveness. “A single tax and reporting scheme would be difficult to design that captures the complexities of different policy objectives. Simplifying is important, but not to the extent that delivers a single blunt instrument.” Others expressed concern that flexibility for SMEs and less energy-intensive users (de minimus reporting) would need to be maintained under a unified scheme.
2. Do you agree that mandatory reporting should remain as an important element of the landscape in driving the uptake of low carbon and energy efficiency measures? If not, why not?

As views on this matter diverge, the EI will leave this question unanswered, enabling its members to express their own views individually.

3. Should such reports require board level sign-off and should reported data be made publically available? Please give your reasons

Yes, board level sign-off is seen by EI members as an important requirement. Engagement of senior management raises the profile and is integral to the success of energy efficiency incentives. Positive incentives rather than penalties may be more effective here: “making an impact on the Board for the right reasons - through opportunities (energy and carbon reduction and saving money) rather than risks (legislative fines). Going from negative discussions to positive can only help with engagement.”

Regarding publically available data, yes, in principle, however further consideration needs to be put into what exactly should be made publically available as there are commercial and competitive concerns for many companies. A light touch may be appropriate for some types of organisations.

4. Do you agree that government should develop a single reporting scheme requiring all ESOS participants (and potentially the public sector) to report regularly at board level? If so, what data should be included in such a report?

In principle, EI members are in favour of such reporting, which is in line with the need for board-level sign off. Any reporting requirements should be closely tied to those required for ESOS, to maintain consistency within an organisation. This may differ across organisations, depending on the business type or sectoral requirements.

5. The government recognises the importance of ensuring market actors have access to transparent, reliable and comparable information to support financing and investment in energy efficiency and low carbon measures. How best can a streamlined report achieve this? To what extent does your response apply to other large companies (as defined in the Companies Act) that are not listed companies?

The EI has left this question unanswered, deferring to the views of individual companies, who are better able to answer this for their own situation.

6. Do you agree that moving to a single tax would simplify the tax system for business? Should we abolish the CRC and move towards a new tax based on the CCL? Please give reasons.

Out of 100 respondents, 48% support this proposal, with 19% disagreeing and 33% unsure.

Those in favour of abolishing CRC argue that for many it is a compliance-only approach. A direct tax or levy such as CCL has more visible impact on the bottom line and therefore is more likely to promote demand reduction. Weaknesses of CRC also include misalignment with financial years, budget reporting and forecasting periods, which can hinder spending planning for current and future financial years.

Those in opposition to this proposal cite the supply-side focus of CCL in contrast to the demand-side angle of CRC. There is concern that moving to a supply-side only measure would be detrimental to demand reduction. Strengths to the CRC include higher visibility due to board-level engagement whereas CCL comprises only a small part of energy invoices. CRC is perceived by some as having stronger impact on demand reduction for energy intensive organisations.
Others also stress that a tax or levy should not focus narrowly on energy use or carbon as units of measurement, but account for other greenhouse gases and pollutants as well. Suggestions include a ‘pollutants tax’ or a weighted sum of all emissions.

Establishment of fair, explicit criteria in the design of this new approach will be necessary to avoid inequalities of benefit or detriment to certain types of organisations or energy sources or other unintended consequences. Response in answer to this question directly from an EI member:

“I have always been a supporter of the CRC as it has made an impact to our board and therefore boosted the profile of energy management within our company.

However if we could get a single tax scheme through the CCL which is ring-fenced and open to the business to spend on energy efficiency initiatives then I am in favour of scrapping the CRC. I see something like a nominated person (can retain the Primary and Secondary Member terminology of the CRC) who reports the energy and carbon elements (including ESOS audit requirements) of a business can draw down on the previous year’s CCL charges in order to initiate energy saving opportunities as long as the company match fund whatever is drawn out. Then add in a compelling event such as you only have the following 12 months in which to spend it, then businesses would be compelled to take action every year otherwise they lose their money. We as energy managers are then making an impact on the Board for the right reasons - through opportunities (energy and carbon reduction and saving money) rather than risks (legislative fines). Going from negative discussions to positive can only help with engagement.

Simplified - In one swoop the CCL charges are applied directly by the energy suppliers (so no business burden), the CCA, ECA and EDR principle are incorporated meaning that business will always be looking at reducing their energy costs through the designated CCL fund which would keep them abreast of the latest technology and provide a competitive advantage for them and the UK market. Whilst at the same time providing a new enhanced market for clean fuels and clean technology to assist.”

The sentiments expressed in this comment were echoed by other EI members.

7. **How should a single tax be designed to improve its effectiveness in incentivising energy efficiency and carbon reduction?**

EI members make the point that it is necessary to distinguish between carbon reduction and energy efficiency; and also between measuring relative improvement (reduction in intensity) vs absolute consumption. We received a wide variety of suggested approaches or elements. These can be roughly grouped as follows:

- **Variable rate based on industry benchmarking**

  A ‘one size fits all’ approach was not seen as useful. A tax may then be based on the carbon intensity of process emissions and sensitive to types of fuel and technologies. Benchmarking to recognise best practice within each industry or sector and also to including de minimus threshold would protect small businesses and charities.

- **Reward for improved energy performance**

  Progressive rewards such as tax relief should be based on reductions in energy intensity, consumption, or increases in efficiency. This could perhaps be based on individual company performance or on a benchmark for similar organisations. Others suggest basing tax relief on absolute savings may be less fair but agree it would reduce the administrative burden.
• Include lifecycle analysis

Whilst it was recognised that this would require more preparation and administration, a holistic, full-cycle approach enables accounting for carbon leakage as well as enabling a tax on imported emissions. For example, a tariff on imported products reflecting their estimated greenhouse gas contribution.

• Clear links to incentives

Tax payers should see the value from any scheme, the connection between reducing energy use or emissions and saving money. Increased tax should not simply reduce capital available for investment with no visible benefit.

8. Should all participants pay the same rates (before any incentives / reliefs are applied) or should the rates vary across different businesses?

The EI leaves questions relating to business rates to individual companies to provide feedback on.

9. Do we currently have the right balance between gas and electricity tax rates? What are the implications of rebalancing the tax rate ratio between electricity and gas? What is the right ratio between gas and electricity rates?

10. Do you believe that the CCA scheme (or any new scheme giving a discount of the CCL or on any new tax based on the model of the CCL) eligibility should only focus on industries needing protection from competitive disadvantage? If so, how should government determine which sectors are in need of protection?

11. Do you believe that the CCA scheme (or new scheme) eligibility should focus on only providing protection to those EII's exposed to international competition and at risk of carbon leakage? If so, how should government assess which CCA sectors are at risk of carbon leakage?

Yes, particular attention to organisations at risk of carbon leakage and international competition would be advisable.

“Review of CCAs – launderettes and rotisserie chicken were two which were suggested were perhaps not fitting candidates for CCAs. In my personal opinion there are categories which are not actually at risk of carbon leakage. Support/avoidance of taxation should be focussed, perhaps even more intensively, on EII's and should also be targeted at the other end of the scale (consumption-wise) in fuel poor households.”

“EII's at significant risk of carbon leakage and UK resulting job losses should, after careful scrutiny, be given exemptions. CAAs should be reviewed to ensure that the sectors covered are genuinely at risk of carbon leakage. Some sectors currently covered by CCA cannot move overseas to deliver their services to UK customers - ranging from data services to launderettes”

12. Do you believe that the targets set by the current CCA scheme are effective at incentivising energy efficiency? Do you believe that the current CCA scheme is at least as effective, or more effective, at incentivising energy efficiency than if participants paid the
full current rates of CCL? How could CCAs be improved? Are there alternative mechanisms that may be more effective?

No comment.

13. Do you believe that incentives could help drive additional investment in energy efficiency and carbon reduction?

Of 100 EI members responding: Yes: 85%; No: 10%; Unsure: 5%

Incentives can play an important role in the drive for business to lead on energy efficiency. France’s climate ambassador, Laurence Tubiana, has been quoted as saying that COP21 should send a very strong signal to the business sector and senior decision makers to create a self-fulfilling prophecy that the low carbon economy is happening. Incentives can be a key part of supporting that signal; however investment decisions are strongly driven by commercial interests.

Those opposed to incentives to drive investment suggest that these take too long to deliver results, and they only supplement investment once linked back to monitoring. These members suggest that financial cost and administrative burden of delivering schemes would be better removed in place of a tax on a utility bill. Many cite that commercial imperatives and profit are the strongest drivers for investment. Incentives and energy saving may only comprise a small part of the investment decision, but if they demonstrate a good return on investment, energy efficiency investments will be made.

Cost avoidance and long-term paybacks are not considered to be as effective as a direct reward or short-term benefit might be. Respondents stressed the difficult trade-offs faced by organisations considering energy efficiency investments. Rapid return on investment, increased productivity, and revenue generation are key drivers for any such decision. The inability to fully understand and account for the full value of energy efficiency investment through co-benefits, costs in other parts of supply chain, potential future benefits, avoided costs, or future guarantees poses a barrier to this type of investment. Energy efficiency investments must compete with other revenue-generating options. Lack of certainty also has a stifling effect on investments. Incentives should be proven and sustained over agreed timescales to effectively gain trust from investors.

14. What is the best mechanism to deliver incentives for investment in energy efficiency and carbon reduction (e.g. tax reliefs, supplier obligations, grants, funding based on competitive bidding)?

EI members recommend a mix of mechanisms to incentivise energy efficiency investment; however half of all suggestions point to some kind of tax relief and another quarter suggest grants, in some cases in combination with supplier obligations.

Notable points include:

- Tax reliefs are easy to implement because they free up capital for organisations to put into efficiency schemes and do not require a payment on the part of the Treasury.
- Positive impacts of tax relief may be limited by an organisation’s tax or debt situation.
- Grants are seen as particularly effective for innovation or large scale projects or energy intensive users. Some cited them for smaller users as well. Grants should be targeted and have specific deliverables attached.
- Competitive bidding is recommended particularly for large scale or complex projects, however, many caution at the blanket use of such a policy, as the perception is that bids are won by the largest bid teams, rather than necessarily the best projects.
The use of supplier obligations were qualified in a variety of ways, including being more suitable for the domestic sector, and cautions over the costs put on suppliers to manage them.

A balanced mix of incentives, with a long term, stable strategy underpinning them, will entice more investment than current approaches, which are perceived by energy professionals to be short-sighted and discontinuous.

Are different approaches needed for different types of business? If so, which approaches work for which business types?

Most EI members agree that, whilst different approaches are likely to be needed for different business types, the underlying principles should be the same to ensure the scheme is easily understood. Specific recommendations include:

- The main distinction is between small businesses/public sector organisations and large energy consumers.
- Some call for reduced charges or exemptions for EIIs to protect UK competitiveness in industries such as manufacturing. These exemptions were seen as relevant only to those businesses at risk of carbon leakage and potentially resulting in job losses.
- SMEs will be limited by resource constraints, both financial and technical, and by the scope of their in-house skills. A lighter touch would be more appropriate for them.

Some members prefer a blanket approach: perhaps taxation of each tonne of carbon at the same rate regardless of business type at the point of emission (polluter pays), based on consumption of fuel by carbon content. Other universal incentives include low interest (or interest free) loans for energy efficiency investments, support for energy assessments, or grants in exchange for demonstration of energy efficiency implementation.

Which approaches should be avoided?

A balance must be struck between complex approaches and over-simplification. Overly-complex criteria, data collection, methods of adoption, long time scales and red tape necessitate expertise and time which can be prohibitive. Equally, ‘one solution fits all’ approaches do not allow stratification between groups or sectors, may be equally ineffective, and may compromise policy objectives.

Approaches which lead to compliance-only complacency, recommendations which are never implemented, and which do not require proof of improvement or other demonstration of their uptake should be avoided. Loopholes which can be taken advantage of by legal teams or those looking to avoid energy efficiency action should also be avoided. It is important that any incentive, benefit, or tax relief should be contingent on verified demonstration of having implemented efficiency measures or made improvements.

Competitive bidding is cautioned against because of inequities in the process which do not necessarily favour the best projects or assure effective implementation by the winning bidder.

A general preference for ‘carrots’ rather than ‘sticks’ prevails, and EI members caution against charges and penalties and tax increases and prefer fiscal encouragement and rewards for improvement.

15. What impact would moving to a single tax have on the public sector and charities?

No comment.
16. How should the merged tax be designed to improve its effectiveness in driving energy and carbon savings from the public sector and charities?

No comment.

17. Should a new reporting framework also require reporting by the public sector?

This would make sense, provided the administration is not overly burdensome. One suggestion was to make better use of existing measures such as DECs.

Conclusions and general remarks

A key message from EI members, and one that is repeated in contexts other than energy efficiency, is the need for strong, clear, consistent policy signals from government. There are two points commonly made here: Clarity of aims - that government needs to demonstrate that it is serious and committed to energy efficiency and carbon reduction; and long-term planning – investor confidence hinges on the continuity of policy frameworks, ensuring that policies will be maintained over time and that any changes do not take business and industry by surprise. Opportunistic and short-term planning can lead to reluctance on the part of investors and weaken the chances of uptake of energy efficiency.

Better communication and engagement with the public is one way to demonstrate the commitment of this government to energy efficiency and carbon reduction and the value of these schemes. Publicising good practice, examples of effective projects, and progress towards targets will all help to demonstrate robustness of policy aims.
Appendix: Selected evidence and detailed recommendations

How should a single tax be designed to improve its effectiveness in incentivising energy efficiency and carbon reduction?

“1. Keep it simple - one payment per unit of energy used (electricity and gas should be at different rates)

2. Unit rate charge for each financial year should be published no later than end Q3 of previous financial year (i.e. before end December) to allow accurate business planning

3. A de minimus threshold should continue to be applied to exempt the smallest businesses and charities (i.e., no change to current CCL approach in this regard)

4. A single tax payment should be linked to the mandatory carbon reporting within company Annual Reports. This mandatory reporting should be extended to all company accounts where energy consumption exceeds the de minimus threshold

5. Direct payment of this tax to HMRC as part of annual returns will increase visibility at Board level (as oppose to the tax being collected via the energy supplier as per current CCL approach). This increased visibility will further incentivise energy efficiency and carbon reduction

6. Calculation of the company carbon emissions should be based on a company purchasing decision rather than on grid average carbon content. Consumption data should be based on a declaration from the supplier to the customer

7. In lieu of any purchasing decision, as a default, the Fuel Mix Disclosure statement of the energy supplier should be used for carbon emissions - this would also encourage suppliers to source lower carbon energy to support cost reduction for business customers”

_____________________________________________________

“Energy efficiency and carbon reduction should not be confused as being the same thing.”

“Energy efficiency improvements should be incentivised through a scheme whereby companies should be able to receive a reduction in their tax equal to a portion of the value of energy efficiency actions they undertake. For example, if they were to demonstrably spend £100,000 on energy efficiency measures, they could be in line for a reduction in their energy tax equivalent to a portion of that. The exact portion would need to be carefully arrived at.”

“The benefits to the UK plc of such a programme would be significant - as well as improving the productivity of the businesses being taxed, it would also provide a much needed boost to the energy efficiency sector, enabling competition and innovation, and keeping the UK at the forefront of this sector, with significant opportunities for exporting of the additional expertise and services.”

“The devil is in the detail and the question of the size of the tax would be refundable, as well as how companies could prove they had carried out the measures. This is where the importance of reporting comes in. Following something along the lines of ESOS reporting, would mean that taxable improvements could be written into an ESOS (or similar annual) audit, which could also be more closely linked to financial audits, enabling costs of energy efficiency investments to be accurately tracked.”
Do you believe that incentives could help drive additional investment in energy efficiency and carbon reduction?

"Incentives are good (e.g. enhanced capital allowances), but regulation is probably better and more definite. The display energy certificate (DEC) should be required on all buildings (it is a simple relationship between actual bills and floor area) and tax linked to the performance band. Above average energy efficiency results in lower taxes (e.g. bands A-C) and higher taxes are imposed on those with energy inefficient buildings (e.g. E - G). The DEC is already specific to building and business type. The tax relief could be linked to the business rates as this is already collected, with some link between local authority receipts and returns to central government (if necessary)."

General evidence

“There is a strong drive to find a mechanism to improve energy efficiency. This is a desire to link energy efficiency drive more directly to the Board Room – suggesting perhaps that mandatory carbon declarations in Annual Reporting will become applicable to more companies.

“A single tax, with a single reporting mechanism (probably amended ESOS) and single incentive method is what makes sense for business.”

Acknowledgements

On behalf of the Energy Institute, this submission was prepared by Sarah George MCIPR and Gareth Parkes MEI as a synthesis of comments from EI members collected by online questionnaire and email submission. It will be followed up by a stakeholder workshop in January 2016 which is in planning stages by the EI, DECC and HM Treasury.

For further information or detail regarding this submission, please contact:

Sarah George MCIPR
Engagement Officer
Energy Institute Knowledge Service
61 New Cavendish Street
London W1G 7AR
t: +44 (0)20 7467 7164
e: sgeorge@energyinst.org