EXPLANATORY MEMORANDUM TO

THE CLIMATE CHANGE LEVY (GENERAL) (AMENDMENT) (No. 2) REGULATIONS 2012

2012 No. 3049

This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the Statutory Instrument

2.1 This Statutory Instrument amends the Climate Change Levy (General) Regulations 2001 (S.I. 2001/838) ("the principal Regulations") and comes into force on 1 January 2013.

2.2 The principal Regulations determine, among other things, the extent to which qualifying power output electricity ("QPO electricity") has been produced in either a fully exempt or a partly exempt combined heat and power (CHP) station and can be certified as such by way of CHP levy exemption certificates (CHP LECs) by the relevant Authority[1].

2.3 The principal Regulations are amended as a consequence of the removal of the exemption from climate change levy (CCL) for electricity that is generated in a CHP station and is supplied to an energy consumer by an electricity utility ("the CHP indirect supplies exemption").

3. Matters of Special Interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The primary legislation containing provisions for CCL is contained in Schedule 6 to the Finance Act 2000 ("Schedule 6"). An exemption from the levy for electricity produced in a CHP station that is supplied by an electricity utility to an energy consumer is contained in paragraph 20A of Schedule 6.

4.2 Part 3 of Schedule 32 to the Finance Act 2012 removes the CHP indirect supplies exemption in relation to CHP electricity generated on or after 1 April 2013. The principal Regulations are amended so that only electricity produced before that date can be certified by way of CHP LECs as being QPO electricity. The regulations are also amended to provide the relevant Authority with revised CHP LEC reconciliation arrangements in relation to CHP stations that have participated in the Department of Energy and Climate Change CHP

[1] The Office of the Gas and Electricity Markets (Ofgem) or the Northern Ireland Authority for Utility Regulation (NIAUR).

Quality Assurance Programme for the completed calendar year ending 31 December 2012.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy Background

- ***What is being done and why***

7.1 The Government announced at Budget 2011 that it would introduce a carbon price floor with effect from 1 April 2013. Supplies of fossil fuels used in electricity generation will become liable either to CCL or fuel duty from that date, charged at the relevant carbon price support (CPS) rate. The level of each rate is determined by the average carbon content of the relevant fossil fuel. The Government also announced at Budget 2011 that it would withdraw the CHP indirect supplies exemption.

7.2 The CHP indirect supplies exemption is subject to State aid approval that has an expiry date of 31 March 2013. As CHP plant provides the simultaneous production of heat and power in a single process, the Government announced at Budget 2012 that, following consultation, it would introduce an exemption from CCL on fossil fuels that are used to produce the non-electricity outputs of a CHP (mainly heat) at the same time that the CHP indirect supplies exemption is withdrawn.

7.3 The objective of removing the CHP indirect supplies exemption and introducing an exemption for the input fuels that are used to produce heat is to ensure that Government support for CHP through the tax system is more direct, provides greater certainty over the long term and offers better value for money for both taxpayers and the operators of CHP stations.

- ***Consolidation***

7.4 There is no intention at present to consolidate the amendments that have been made to the principal Regulations.

8. Consultation Outcome

8.1 A consultation on introducing a carbon price floor was released on 16 December 2010 and the Government's response to the consultation was published on 30 March 2011. The key points of the response were: the carbon price floor would come into effect on 1 April 2013; there would be lower carbon price support rates for supplies of fossil fuels to CHP stations; and those

generators that install carbon capture and storage (CCS) technology would be entitled to a one percentage point reduction in the appropriate CPS rate of CCL for every one percentage point of carbon dioxide captured rather than emitted.

8.2 The draft legislative proposals introducing the partial reliefs from the CPS rates for supplies to CHP and those generators with CCS technology, and the removal of the CHP indirect supplies exemption were published for consultation on 6 December 2011. In respect of the removal of the indirect supplies exemption, the Government indicated that electricity utilities would be able to continue to allocate CHP LECs that they acquired relating to CHP generation made before 1 April 2013, but only for a limited number of years. This would give them time to use up their stocks, while ensuring that CHP electricity generated after 1 April 2013 did not benefit from exemption from CCL. The length of this transitional relief would be announced at Budget 2012.

8.3 As a result of that consultation process, and in response to representations made by the CHP industry and electricity utilities, the Government announced at Budget 2012 that the original proposal to provide lower CPS rates for fossil fuels used in a CHP would be replaced with an exemption for the input fuels used to generate non-electricity outputs (mainly heat). Electricity utilities would also be given until 31 March 2018 to use up their stocks of CHP LECs.

9. Guidance

9.1 Six public notices covering CCL are available at www.hmrc.gov.uk. Where appropriate, these will be amended to reflect the removal of the CHP indirect supplies exemption.

10. Impact

10.1 Of the CHP plants registered in the CHP Quality Assurance Programme, around 200 currently export electricity to the National Grid for the purposes of enabling electricity utilities to make indirect supplies of CHP electricity. Electricity generated in a CHP station after 1 April 2013 and acquired by an electricity utility will not be eligible for exemption.

10.2 However, if the electricity was generated in an eligible CHP station before 1 April 2013, electricity utilities will be able to exempt the supply to a business consumer up to and including 31 March 2018. This gives them 5 years to use up any stockpile of CHP LECs they hold.

10.3 A Tax Information and Impact Note (TIIN) covering the contents of this instrument was published on 6 December 2011 alongside a draft of the Finance Bill 2012 and an instrument that included these changes. An updated TIIN was published on Budget day, 21 March 2012. It is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating Small Business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is a general tax provision and the same for all firms.

11.3 The basis for the final decision on what action to take to assist small business is described in paragraphs 7.1 to 7.3 above, so no such action is taken for this general tax provision.

12. Monitoring and Review

12.1 Reviews of compliance with the practical application of the new regulations will form part of the compliance review programme of the Excise, Customs, Stamps and Money Directorate of HMRC.

13. Contact

13.1 Cathy Smith at HMRC Tel: 020 7147 0668 or e-mail: cathy.smith2@hmrc.gsi.gov.uk can answer any queries regarding the instrument.