EXPLANATORY MEMORANDUM TO

THE CLIMATE CHANGE LEVY (FUEL USE AND RECYCLING PROCESSES) (AMENDMENT) REGULATIONS 2026

2026 No. [XXXX]

1. Introduction

1.1 This Explanatory Memorandum has been prepared by His Majesty's Revenue and Customs ("HMRC") on behalf of His Majesty's Treasury and is laid before the House of Commons by Command of His Majesty.

2. Declaration

2.1 Dan Tomlinson MP, Exchequer Secretary to the Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 Judith Kelly, Deputy Director for Excise and Environmental Taxes at HMRC, confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Ange Colquitt at HMRC can be contacted by email at the following address with any queries regarding the instrument: energy.taxes@hmrc.gov.uk. Alternatively, the department can be contacted by telephone: 03000 587862.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 Climate change levy ("CCL") is a tax on the supply of taxable commodities (electricity, gas and solid fuels) that are not for domestic or charity use. Taxable commodities that are classified as not being used as fuel are exempt from CCL. Taxable commodities that have mixed uses may also be classified as not being used for fuel. A mixed use is where a taxable commodity is partly used as a fuel and partly used for other purposes.

4.2 This instrument exempts electricity used in electrolysis to produce hydrogen from CCL. It also exempts natural gas used partly as a source of carbon dioxide to produce sodium bicarbonate from soda ash. It does this by amending Parts A and B of Schedule 1 to the Climate Change Levy (Fuel Use and Recycling Processes) Regulations 2005 (S.I. 2005/1715) ("the principal Regulations") so that their supply for use in the processes described are classified as non-fuel uses.

Where does the legislation extend to, and apply?

4.3 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.

4.4 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

5.1 CCL is a tax designed to encourage energy efficiency. In keeping with that rationale, the non-fuel use exemption has always formed part of CCL on the basis that taxable commodities are exempt from the tax when they are not used for energy purposes.

5.2 When produced in a low carbon manner, hydrogen has the potential to support the government's 2030 clean power and 2050 net zero ambitions. One method of producing low carbon hydrogen is via electrolysis of water. Presently, electricity used to produce hydrogen in this way is subject to CCL even though it is not used as a fuel. This puts this method of hydrogen production at a disadvantage compared to hydrogen production via steam reformation. The use of natural gas in the latter process is already exempt from CCL on the basis that it is not used as a fuel.

5.3 Presently, natural gas used as a source of carbon dioxide to produce sodium bicarbonate from soda ash is also subject to CCL, even though it is partly used as a non-fuel in that process. The use of natural gas as a source of carbon dioxide to produce sodium bicarbonate from soda ash is a mixed use and its use as a raw material in that process is not "merely incidental" to its use as a fuel[1]. In the UK, the production of sodium bicarbonate via other methods ceased in 2025, in part because of high energy costs.

5.4 As a tax designed to encourage energy efficiency, it is consistent with the objectives of CCL for these uses of electricity and natural gas to be exempt from the tax. This would also support wider government objectives by removing an additional cost that could discourage investment in these production methods.

5.5 There is interest from industry in exempting these uses of electricity and natural gas.

What was the previous policy, how is this different?

5.6 The supplies of electricity and natural gas that will be exempted from CCL as a result of this instrument have not previously been exempt under the non-fuel use exemption. It is not known why electricity used in electrolysis to produce hydrogen was not exempted when CCL was first developed over 25 years ago, but recent negotiations with potential hydrogen production projects under the government's Hydrogen Allocation Rounds[2] (a separate government mechanism to help fund such projects) and therefore the expansion of the use of this process, have brought the issue to light now. Using natural gas as a source of carbon dioxide to produce sodium bicarbonate from soda ash is a new technology that did not exist when the principal Regulations were made or last amended.

6. Legislative and Legal Context

How has the law changed?

6.1 These Regulations amend the principal Regulations and are made under paragraph 18(2) and (3) of Schedule 6 to the Finance Act 2000. They specify that electricity used in electrolysis to produce hydrogen, and natural gas as a source of carbon dioxide to

[1] Under paragraph 18(3) of Schedule 6 to the Finance Act 2000, when specifying "mixed uses" of a commodity that are to be taken as being non-fuel uses, the Treasury must have regard to the object of securing that a mixed use is not specified as being a use of the commodity otherwise than as fuel if it involves the use of the commodity otherwise than as fuel in a way that is merely incidental to its use as fuel.

[2] Hydrogen Allocation Rounds: https://www.gov.uk/government/collections/hydrogen-allocation-rounds

produce sodium bicarbonate from soda ash, are non-fuel uses. This will exempt their supply for these uses from CCL under paragraph 18(1) of Schedule 6 to the Finance Act 2000. Electricity and natural gas supplied for these uses were not previously exempt.

Why was this approach taken to change the law?

6.2 Paragraph 18(1) of Schedule 6 to the Finance Act 2000 exempts the supply of taxable commodities that are not used as fuel from CCL. Paragraph 18(2) provides that Regulations may specify when the use of a taxable commodity should or should not be treated as a fuel use, which includes, under paragraph 18(3), taxable commodities with mixed uses.

6.3 Regulation 3 of the principal Regulations provides that taxable commodities used in a way that is specified in Schedule 1 are non-fuel uses and any other use is a fuel use. Amending that Schedule was therefore considered the only way to extend the exemption to the taxable commodities used in the two new processes described in the instrument.

7. Consultation

Summary of consultation outcome and methodology

7.1 At Spring Statement 2025, the government committed to removing CCL costs from electricity used in electrolysis to produce hydrogen and launched a consultation[3] to determine the best way to achieve this. The consultation closed on 7 May 2025. There were 49 responses to the consultation and 41% of those were from hydrogen producers. Government officials also met with industry representatives, technical experts, and other government departments as part of the consultation process.

7.2 In general, consultation respondents felt there needed to be a balance between breadth and speed. Most agreed adding electricity used in electrolysis to produce hydrogen to the non-fuel use exemption would meet the government's commitment, and could be introduced quickly so that CCL costs did not prevent hydrogen production projects using this technology from proceeding. In the long term, hydrogen industry stakeholders were interested in a broader exemption for hydrogen production.

7.3 The government therefore decided to add the use of electricity to the non-fuel use exemption, recognising this is the timeliest option to ensure these projects were not deterred as a result of CCL costs that are not faced by other non-fuel uses. The government confirmed it will consider CCL's broader treatment of the production and supply of hydrogen as part of the CCL review[4] also announced.

7.4 The consultation also included questions to inform a wider review of CCL. One response to this part of the consultation highlighted a new process for producing sodium bicarbonate which a business would like to commence in the UK. It involves burning natural gas to produce heat and carbon dioxide. The carbon dioxide is combined with soda ash and water, heat is applied, and sodium bicarbonate is produced from the reaction.

7.5 After consulting with potentially affected stakeholders and independent technical experts, the government concluded that this use of natural gas is a mixed use and that its use as a non-fuel is not "merely incidental" to its use as a fuel.

[3] Consultation: https://www.gov.uk/government/consultations/climate-change-levy-electrolytic-hydrogen-and-energy-context

[4] See government response to the above consultation (published on the same weblink).

8. Applicable Guidance

8.1 The small number of businesses affected by these Regulations will be contacted directly. Guidance on the non-fuel use exemption is available on the GOV.UK website[5] and this will be updated to reflect the effect of these Regulations.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note covering this instrument will be published on the GOV.UK website.[6]

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies. A small number of hydrogen producers will benefit from the exemption once it comes into force. For the sodium bicarbonate production process, one business is expected to benefit.

9.3 The legislation does not impact small or micro businesses.

9.4 There is no, or no significant, impact on the public sector because this sector is not expected to be producing hydrogen or sodium bicarbonate.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The impact of this measure will be monitored and evaluated as part of the normal Budget process.

10.2 The instrument does not include a statutory review clause because it is exempt under section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 (provisions relating to tax).

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Exchequer Secretary to the Treasury has made the following statement regarding Human Rights:
"In my view the provisions of the Climate Change Levy (Fuel Use and Recycling Processes) (Amendment) Regulations 2026 are compatible with the Convention rights."

[5] Guidance on the non-fuel use exemption: https://www.gov.uk/government/publications/excise-notice-ccl13-climate-change-levy-reliefs-and-special-treatments-for-taxable-commodities
[6] Tax Information and Impact Note: https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").