



HM Treasury

Electricity generator levy

Technical note

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Background

1.1 The UK economy has been hit by significant external shocks in recent years. Putin's weaponisation of gas supplies to Europe has pushed prices to record levels. In the UK, energy prices have risen to eight times their historic levels.

1.2 The UK's economic and fiscal outlook has deteriorated materially since March 2022 and household and business energy bills have increased significantly. The government has absorbed a substantial proportion of the price increase through the Energy Price Guarantee, Energy Support Scheme, and one-off payments for households, as well as the Energy Bill Relief Scheme for businesses.

1.3 In addition, the energy crisis has resulted in extraordinary profits arising to certain participants in the UK energy market.

Oil and gas production

1.4 The increase in the wholesale price of gas, alongside the increase in the price of oil, has resulted in extraordinary profits to businesses engaged in the extraction of oil and gas in the UK Continental Shelf.

1.5 This motivated the introduction of an additional tax on the profits from oil and gas extraction from May 2022, the Energy Profits Levy. Following the changes made to the levy's rate and duration at the Autumn Statement, the Energy Profits Levy is now forecast to raise over £40 billion by 2027-28.

Electricity generation

1.6 Non-gas fired generation has a central role in the government's energy security, decarbonisation and levelling up ambitions. The government recognises the economic benefits it can derive from renewable energy and is committed to ensuring a competitive investment landscape for the sector, including through our Contracts for Difference Scheme which has enabled around 26GW of new low-carbon capacity since launching in 2014.

1.7 However, in the short term, the wholesale price of gas is also resulting in extraordinary profits arising to some businesses generating electricity in the UK.

1.8 The market price for electricity generated in the UK is driven by the marginal cost of the most expensive form of electricity generation needed to meet demand which, due to the current composition of the UK generation sector, is often gas-fuelled generation.

1.9 The substantial increase in the wholesale price of gas has therefore significantly increased the wholesale market price of electricity. This higher market price can be captured to a greater or lesser extent by all electricity generators in the UK.

1.10 This includes those generating electricity from nuclear and renewables sources, whose marginal costs have been less impacted by exceptional global conditions and are now substantially below the marginal costs of gas generators upon which the market electricity price is based.

1.11 The overall result is some electricity generators in the UK are realising extraordinary returns; from being able to sell electricity at a price that has been inflated by costs to which they are not exposed; and a price that then well exceeds the price needed to provide investors with a reasonable return on the costs of production and exceeds any reasonable expectation of prices when capital was invested.

1.12 These extraordinary returns are then being realised at a cost to customers through the substantial increase in the amount that households, businesses and other customers are being required to pay for their energy needs.

Responding to the challenges in the electricity generation market

1.13 The only sustainable and enduring solution to the link between the cost of gas and the price paid by customers for all electricity is to reform the energy market and reduce the reliance on gas generation. Beyond a levy on extraordinary returns, market structures should ensure that generators of all types are able to make a fair profit, commensurable with their investments and the risks they take.

1.14 The Review of Electricity Market Arrangements is assessing several options for reform, which will deliver the enduring electricity market framework necessary to support a clean, secure and low-cost energy system that works for businesses, industry, and households. The government recently consulted on these reforms and will be setting out its response and next steps shortly.

1.15 However, in recognition of the time it will take to deliver those reforms, and to ensure electricity generators make an appropriate contribution to the substantial cost of support for energy bills, the government has announced at Autumn Statement 2022 that it will introduce a levy on extraordinary returns from electricity generation in the UK.

1.16 This is an exceptional and time-limited measure that responds to the effect that unique geopolitical events, when combined with structural challenges within in the UK market, are having on the prices being paid for electricity in the UK.

1.17 The levy will be introduced from 1 January 2023 and is then forecast to raise around £14.2 billion over the forecast period (2022-2028), as announced at Autumn Statement.

1.18 This technical note sets out the government's proposal for how the Electricity Generator Levy will operate. This is intended to help generators prepare for the new levy, and to form a basis for conversations with relevant generators about how it will be implemented in legislation.

Design of the levy

Scope

1.19 The levy will apply to corporate groups, or, where relevant, standalone companies, that undertake electricity generation in the UK and are either connected to a national grid or connected to local distribution networks.

1.20 The levy will be applied to groups generating electricity from nuclear, renewable and biomass sources who are benefitting from a significant increase in the price received for their output without a corresponding increase in the costs of generation.

1.21 The levy will not apply to electricity that is generated under a Contract for Difference entered into with the Low Carbon Contracts Company Ltd (LCCC).

1.22 The levy will be limited, through a de minimis threshold, to those groups generating more than 100 Gigawatt-hours (GWh) per annum of electricity from in scope generation assets in a qualifying period.

Levy calculation

1.23 In scope groups will be subject to a 45 percent tax charge on a measure of 'Exceptional Generation Receipts'.

1.24 Exceptional Generation Receipts will be calculated as:

Generation Receipts – Electricity Generation x Benchmark Price – Allowance

1.25 Where:

- **Generation Receipts** total receipts of a group from in scope UK electricity generation.
- **Electricity Generation** means electricity generated in the UK from in scope generation in Megawatt-hours (MWh).
- The **Benchmark Price** is set at £75 per MWh. For the purposes of the tax, this represents the average price above which generator returns are considered to be exceptional. The portion of generators' earnings below this level will not be subject to the levy. The benchmark price is set at £75 per

MWh – considerably higher than the average wholesale electricity price in the decade up to 2021

- An **Allowance** is set at £10m per annum for the group.

1.26 This calculation will be undertaken at an aggregate level across all in scope generation of the group in respect of a qualifying period. The qualifying period will be aligned to the accounting period of the company responsible for administering the levy for the group (the responsible company).

1.27 The levy will not be deductible from profits subject to Corporation Tax.

1.28 The levy will be administered in the same way as Corporation Tax. In particular, amounts will need to be returned within the responsible company's Corporation Tax Return. The levy will need to be paid in line with the responsible company's normal payment dates for Corporation Tax (including under the quarterly instalment payments regime where appropriate).

Revenue calculation

1.29 The measure of revenue used in the calculation above will be the revenue received for output from in scope generation in the qualifying period irrespective of when the relevant contracts were entered into.

1.30 For example, the revenue that a group receives for electricity generated in 2024 could be a function of both the price agreed under forward contracts in respect of 2024 output and the price received from selling unhedged 2024 output in the day-ahead and intra-day markets. It is anticipated that this measure will align closely with the timing of revenue recognition for financial reporting purposes.

1.31 The revenue measure will then be the appropriate measure of revenue attributable to in scope generation.

1.32 Where a group's generation output is sold to third parties the revenue measure will be the third-party revenue that members of a group receive for electricity generated in the UK irrespective of whether the sale is made by the company that owns the relevant station or another member of the group.

1.33 Where output is not directly sold to third parties but is used within a downstream UK supply business that generates revenue from the sale of electricity to end consumers the measure of revenue will need to identify the wholesale component of those receipts.

1.34 The levy will apply to revenue from electricity generated in the UK both sold in the UK and exported. It will not apply to electricity generated outside the UK and imported.

1.35 The measure of revenue will cover revenue from all potential routes to market including purchase power agreements, long forward contracts, and trading within the day-ahead and intra-day markets.

1.36 The government considers that the measure of revenue should take account of or be adjusted for:

- Revenue from accepted balancing market offers
- The net impact of imbalance settlement
- Gains or losses on financial derivatives used to hedge output and/or group trading relating to output e.g. buying back electricity in the market at a higher or lower price than output was previously sold.

1.37 The revenue measure will not include revenue that renewables generators earn from the sale of Renewables Obligation Certificates or revenue from capacity market payments.

1.38 Further consideration will be given to some of the detailed questions that might arise in respect of the revenue measure, including how receipts or payments for accepted balancing market bids should be treated.

Joint ventures

1.39 The levy will be designed to cover electricity generated through joint venture structures.

1.40 Consideration will be given to how the tax is most appropriately applied to such structures.

1.41 One approach would be for the tax to be applied to corporate JVs in the same manner as it applies to other corporate groups. Equally consideration might need to be given to bespoke rules for JVs to reflect the relationships that might exist between the JV and those with interests in the JV e.g. in respect of the sale of JV generation output.

Timing and implementation

1.42 The levy will take effect from 1 January 2023 and will be applied to receipts in respect of generation of electricity by in scope generation assets after that date.

1.43 The levy will be legislated to end by 31 March 2028. If electricity prices that the group receives fall below the benchmark price (£75/MWh) before the levy is repealed, no levy would be due in respect of those amounts.

Further design considerations

Gas generation

1.44 Gas generators are in a different position from non-gas generators.

1.45 While gas generators are experiencing increased revenue from the substantial increase in the market prices of electricity, they are also experiencing severely inflated costs from the substantial increase in the price of gas inputs.

1.46 The “spark spread” is the measure of the difference between the wholesale market price of electricity and its cost of production using gas as an input. While there has been a widening in the spark spread, this in part reflects the unique market risks that gas generators are currently exposed to.

1.47 The government does not therefore think it appropriate to include gas generators within scope of the levy and thinks that the inclusion of gas generators could have unintended impacts on pricing with implications across the entire market or on the dispatch decisions of certain business models. This approach is consistent with gas generation being excluded from similar tax and regulatory interventions overseas.

Pumped storage hydroelectricity, battery storage, coal and oil

1.48 The levy will not be applied to pumped storage hydroelectricity or battery storage. These are flexible technologies that allow energy to be stored and then converted into electricity at times of high customer demand. The government considers that the application of the levy to these business models would be inappropriate and create unfair outcomes or undue distortions to decision making and dispatch.

1.49 The Electricity Generator Levy will not apply to coal or oil generation. This reflects that these forms of generation make up an extremely small and declining proportion of UK generation, are reliant on fuel inputs whose costs are volatile and/or have risen significantly in response to the Russian invasion and serve a unique function ensuring the resilience of the UK market, often providing back-up power under special contract with the National Grid.

1.50 Generators are subject to a separate regime for taxing their use of fossil fuels, which includes the Emissions Trading Scheme and Carbon Price Support, which adds a carbon price on coal, oil and gas used in power stations in Great Britain. This helps reduce the use of fossil fuels in the power sector while supporting low-carbon electricity supply.

1.51 This does not change the government’s commitment to phasing out coal power generation.

Exceptional costs

1.52 The measure of extraordinary generation receipts, to which the levy will be applied, will only take into account the limited costs specified in para 1.36 (e.g. the costs of purchasing back electricity in the market).

1.53 The government recognises that some of the benefit that generators are deriving through increased profit from higher electricity prices may be reduced by increases in the cost of production since the start of the energy crisis.

1.54 However, the government's expectation is that the increase in output prices has far exceeded the increase in costs of production for the generating technologies within scope of the levy.

1.55 Furthermore, the benchmark price has been set at a level that well exceeds prior expectations of price levels during the forthcoming period to ensure that the measure of extraordinary returns allows for some input cost inflation.

1.56 If the measure of extraordinary generation receipts was to take account of or be reduced by additional costs then those costs would themselves need to be extraordinary (i.e. costs that have risen to a similar extent to electricity prices and for reasons that are connected with the energy crisis).

1.57 This might, for example, be relevant to generators that have experienced a substantial increase in the cost of fuel needed to generate electricity and an increase that is expected to persist moving forward.

1.58 In that case consideration could be given to the measure of extraordinary generation receipts being reduced by a measure of exceptional costs.

Next steps

1.59 HM Treasury and HMRC will reach out to relevant generators to discuss with them how the model set out in this technical note will be implemented in legislation.

1.60 If you think you will be within scope of the levy and wish to discuss, please get in contact through:
electricitygeneratorlevy@hmtreasury.gov.uk.

1.61 The draft legislation will be published in mid-December.

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk