HM Revenue & Customs

Technical note - Carbon Emissions Tax

Revised 29 March 2019

Chapter 1 - Introduction

This document sets out further detail on arrangements for carbon pricing in the event that the UK leaves the EU on 12 April 2019 without a deal.

Leaving the EU with a deal remains the government's top priority. However, it is the duty of a responsible government to prepare for all eventualities, including 'no deal', until the outcome of those negotiations is certain.

If the UK secures an implementation period, it would remain a member of the EU Emissions Trading System (EU ETS) during the implementation period. The government is continuing to develop options for long term carbon pricing, including remaining in the EU ETS; establishing a UK ETS (linked to the EU ETS or standalone) or a carbon tax.

The UK would be excluded from participating in the EU ETS in a 'no deal' scenario. This means that current participants in the EU ETS who are UK operators of installations would no longer take part in the system. Budget 2018 announced that, in the event that the UK leaves the EU without an agreement in March 2019, a new Carbon Emissions Tax would be introduced from 1 April 2019 on emissions of carbon dioxide (and other greenhouse gases on a carbon equivalent basis) from UK stationary installations currently in the EU ETS. In the event that the UK leaves the EU on 12 April 2019 without a deal, the Carbon Emissions Tax would be introduced from 15 April 2019. The aviation sector would not be subject to the Carbon Emissions Tax.

This document provides more information on how the tax would work.

Who should read this document

Stationary installation permit holders currently covered by the EU ETS. This includes: power generators; certain large industrial premises and manufacturers, including food processing plants; certain public sector facilities; and small emitters and hospitals covered by simplified reporting arrangements.

Further questions

A summary of the impacts of introducing Carbon Emissions Tax is set out in the Tax Information and Impact Note published at Budget 2018. This is available on the gov.uk website.

If you have any questions about the Carbon Emissions Tax, please contact Andy Jameson on Telephone: 03000 586082 or email: carbon.taxation@hmrc.gov.uk

Chapter 2 - Summary

The new tax announced at Budget 2018 would maintain a carbon price for those stationary emitters currently covered by the EU ETS, supporting the UK's strong environmental signals and contributing towards the UK meeting its legally binding carbon reduction targets after EU exit. It would also aim to replace the revenue lost from the auctioning of EU Allowances (EUAs) which would result from the UK leaving the EU ETS. It would maintain similar arrangements for industrial installations deemed to be exposed to significant risk of carbon leakage, to support their competitiveness.

The government remains committed to maintaining the Single Electricity Market on the island of Ireland and understands the importance of carbon pricing to this market. In a 'no deal' scenario the UK will aim to ensure that carbon pricing does not hinder the effective operation of the system.

All current participants in the EU ETS who are UK operators of stationary installations would be set an annual emissions allowance for the purposes of the tax. For permit holders outside the simplified reporting scheme this would be based on the allocation of free EUAs that would have been allocated to installations under Phase III of the EU ETS. For those currently covered by the simplified reporting arrangements, the allowance would be based on their current emissions target.

The first tax period would run from 15 April 2019 to 31 December 2019 with the first bills sent out by HM Revenue and Customs (HMRC) in 2020 (thereafter tax periods would cover 12 month periods starting in January). Installations would continue to report their activities annually under the existing Monitoring, Reporting and Verification (MRV) scheme and, as at present, this information would establish how many tonnes of greenhouse gases they emit during the reporting period. Emissions above the tax emissions allowance would be taxed on a carbon equivalent basis with installations required to make one payment a year to cover the tax due. The rate for 2019 would be £16 per tonne.

Subject to state aid clearance, the scheme to compensate energy-intensive industries for the indirect emission costs of the EU ETS would remain in place to compensate for the indirect emission costs of the new tax.

Although the main structure of the tax, including the rate, is set out in Finance Act 2019, with the tax ready to be commenced should the UK leave the EU without a deal a consultation on the more detailed arrangements would take place later in 2019, should the tax be required. The detailed arrangements covered by this consultation are summarised in chapter 4 of this document under 'Proposed legislation'.

Chapter 3 of this document, which sets out more detail on how the tax would operate, is therefore subject to the outcome of that consultation**.** If the tax went ahead, this document would be further updated no later than spring 2020 once the tax design had been finalised following the 2019 consultation.

Chapter 3 - How the tax would operate in detail

The EU ETS requires participants to obtain permits to emit and then to submit a report annually with details of their activities across the previous calendar year, from which their emissions across the period are calculated. The UK will continue to operate both a permitting and a reporting regime after leaving the EU ETS.

Installations will continue to be permitted to emit for EU ETS compliance before EU exit date and permits will remain valid after leaving the EU ETS although minor amendments to them may be necessary to reflect leaving the EU ETS and the introduction of the tax.

Any stationary EU ETS installation currently covered by the permitting system and the emissions reporting scheme (including those in a simplified reporting scheme for small emitters and certain hospitals) would remain subject to the reporting requirements and potentially become liable to pay the tax, as would any installation that became permitted to emit after the start of the tax.

There would be no requirement for installations to register for tax or send in a tax return – most information needed to calculate tax liability and to bill the installation would be taken by HMRC from the existing data held by regulators. The tax year would cover the same calendar year period as under the existing monitoring, reporting and verification system, with installations continuing to use ETSWAP to submit independently verified data to environmental regulators on their activities covering the period 1 January to 31 December. They would continue to do this by 31 March each year. As a result, by 30 April each year, independently verified data would continue to be available on each installation's greenhouse gas emissions covering the previous calendar year. HMRC would use these data to generate a tax bill, which would be sent to installations in May, with payment required within a specified period agreed following consultation. Transitional arrangements (see section below) would apply in the first tax year as it would cover only 8½ months as a result of the tax starting part way through the year.

For permit holders outside the simplified reporting scheme the tax would be based on the amount by which reported emissions exceeded an emissions allowance set for tax purposes for each installation in advance of the tax year. For 2019 and 2020, the allowance would be set at the level of free allocation of EUAs under Phase III of EU ETS, with an installation paying tax only if its emissions exceeded its allowance, albeit that 2019 allowances would be set at 71.5% of the full year level (see transitional arrangements section below). For power generators who receive no free allocation of EUAs under EU ETS, the allowance would be set at zero. Installations that became permitted after the UK left the EU ETS would have no EUAs on which to base their emissions allowance - their allowance would be set in a comparable way to existing EU ETS participants.

Premises covered by the simplified reporting scheme would continue to operate as they do at present except that the tax (rather than the current civil penalty) would be payable on emissions above the allowance. The tax emission allowance would be set at equivalent levels to the targets that would have been set for them under the current simplified reporting scheme.

HMRC would tax emissions in excess of the tax emissions allowance on a carbon equivalent basis per tonne. For 15 April to 31 December 2019 the rate would be £16 per tonne. The rate for years beyond 2019 would be set at future Budgets.

The person liable for tax covering all emissions throughout the tax year would be the permit holder for the installation at 31 March even if there were to be a change of permit holder during the tax period. Provisions would be made for situations where installations became insolvent during the tax year.

A penalty would be introduced for a failure to pay the tax due and the existing penalty for carrying out a regulated activity without a permit would be amended to account for the introduction of the tax.

A process would be introduced to provide for rights to a review and appeal of decisions relating to the tax.

Transitional arrangements for first tax year

As the tax would be introduced from 15 April 2019, the arrangements for the first year would differ from the arrangements set out above. The first tax period would run for only 8½ months and cover the period from 15 April to 31 December 2019. As indicated above, installations' emissions allowances for 2019 would be set at 71.5% of the level that would have applied had the first tax period covered 12 months. Although they would still need to monitor their emissions for the full 12 months, installations would need to submit 8½ months' activity data by 31 March 2020 covering this first tax period. Payment details for the first tax year would be confirmed after the consultation planned for 2019 (see chapter 2 of this document) but it is possible that tax bills for 2019 would be sent out later than May 2020.

Chapter 4 - Legislation

Current law

The Greenhouse Gas Emissions Trading Scheme Regulations 2012 set out the domestic law relating to free allocation of EUAs and permitting requirements, as well as the simplified reporting arrangements for small emitters and certain hospitals. These regulations implement Directive 2003/87/EC which established a system for greenhouse gas emission allowance trading within the EU and set out the framework for the important features of the system, including requirements to obtain a permit to carry out activities within the scope of the Directive and then to monitor, report and verify emissions in each calendar year.

EU subordinate legislation made under Directive 2003/87/EC includes:

- Commission Regulation 601/2012, which sets out detailed rules relating to the monitoring and reporting aspects of MRV; and
- Commission Regulation 600/2012, which sets out the detailed rules for the verification aspects of MRV.

Proposed legislation

Finance Act 2019 creates a new Carbon Emissions Tax, setting the scope, rate and basic structure of the tax and establishing that it would be payable only on emissions above an emissions allowance set for each installation. The Act also provides for a statutory instrument or instruments which would be laid in early 2020 following a consultation in 2019 (see chapter 2). The instrument or instruments would be wide-ranging and would include:

- provision for the level of the tax emissions allowance
- amending existing emissions reporting requirements to adapt them for the tax
- the payment and tax collection arrangements, including how long businesses need to pay the bills issued by HMRC
- decisions on which the taxpayer would be able to seek a review and against which they would be able to appeal, and
- record-keeping requirements.

The Finance Act 2019 legislation for this measure would be brought into effect by statutory instrument, and take effect only if the UK leaves the EU without an agreement with the EU.

Chapter 5 - Background

The government currently sets a total carbon price, created by the price of allowances from the EU ETS and the Carbon Price Support (CPS) rate per tonne of carbon dioxide (t/CO_2) which tops up the EU ETS price for electricity generators. The total carbon price is designed to provide an incentive to invest in low-carbon power generation. In a ‘no deal’ exit from the EU the CPS would remain in place.

EU Emissions Trading System

The EU ETS, which was introduced in 2005, is a ‘cap and trade’ scheme designed to set a price for carbon emissions to encourage their reduction. It applies to large emitters of greenhouse gases in the EU, including:

- power generators;
- large industrial emitters, including chemical and pharmaceutical companies and food processing plants; and
- aircraft operators.

The EU ETS operates in phases and includes rules determining how many free EUAs participants are allocated each year. Currently the EU ETS is in phase 3 which ends on 31 December 2020.

The EU ETS requires participants to obtain permits to emit and then to submit a report annually providing details of their activities across the previous calendar year, from which their emissions across the period are calculated. All greenhouse gas emissions are calculated on a carbon equivalent basis. The data would continue to be collected following the UK’s departure from the EU.

Industrial installations, generally subject to international competition, are shielded from the full costs of the EU ETS through the allocation of a certain quantity of free EUAs which cover a proportion of their emissions for the year. Some installations need to purchase EUAs to top up their free allocation and others (including power generators) receive no allocation of free EUAs and need to buy enough to cover all of their emissions. Installations can trade EUAs with other participants as needed. At the end of the year all installations must surrender enough EUAs to cover all of their emissions to avoid fines being imposed.

The EU ETS also provides for a simplified reporting scheme for small emitters and certain hospitals, who are set annual emissions targets rather than being allocated EUAs. There is no requirement for verified reports and a civil penalty charge (calculated according to the carbon price) is levied on emissions above the target.

Carbon Price Support

The CPS tax was introduced in Great Britain in 2013. The CPS rate per t/CO_2 is used as the basis for setting individual CPS rates for each of the taxable commodities. The CPS rates of Climate Change Levy apply to fossil fuels used in electricity generation that are taxed under the CCL regime (gas, solid fuels and liquefied petroleum gas). The CPS rates of Fuel Duty apply to oils and bioblends used in electricity generation.

As CPS rates do not apply in the Republic of Ireland, introducing them in Northern Ireland would have distorted the Single Electricity Market covering the island of Ireland. The EU ETS, on the other hand, covers the whole of the island of Ireland.

Budget 2014 announced that the CPS rates would be capped from 1 April 2016 – 31 March 2020 on the basis of a maximum rate per t/CO2 of £18.