20th February 2023

Rt Hon Jeremy Hunt MP
Chancellor of the Exchequer
HM Treasury

## Maintaining UK Investment Attractiveness and the Electricity Generator Levy

Dear Chancellor,

I am writing to express our concern that the UK is falling behind in attractiveness to the investors and innovators who are essential to deliver the UK's energy security and net zero strategy, and to call on you to take action in the Budget.

Regen works with the clean energy sector to accelerate the development and deployment of low carbon technologies. We are in daily contact with a wide range of investors, project developers, infrastructure providers, universities and innovation companies. We also work with smaller UK companies in the clean energy supply chain. Therefore, we have a good understanding of the how these organisations approach investment decisions, and their changing attitude towards the UK as a place to do business. An example of our work is the Day in the Life of the Energy System 2035,which gives an interactive narrative of how our future low carbon electricity system may operate.

The UK is at a critical juncture. We have the opportunity for a step-change in investment that would drive growth, job creation, innovation, new infrastructure and lower cost energy. As Chris Skidmore MP identified in his Net Zero Review, investors, encouraged by the UK's commitment to achieve net zero, have developed a huge pipeline of projects that could be brought forward in relatively short order – renewable generation, energy storage (batteries), electric vehicle charging infrastructure, hydrogen electrolysis, and a whole range of digital and smart energy solutions.

However, the climate for investment to bring these projects to fruition has deteriorated. Barriers to investment include the lack of network infrastructure capacity, planning barriers, skills and supply chain constraints, currency and cost of capital changes and (probably) some Brexit effects. Investors are also being dissuaded by perceived policy risk, including: the lack of an overall energy delivery plan, stop-start support policies, potentially ill-conceived market changes (such as a shift to locational marginal pricing) and the treatment of renewable generation under the terms of the new Electricity Generator Levy (EGL).

Furthermore the US, and our EU neighbours, are putting in place policy and support packages to attract clean energy capital and technology developers.

It is, therefore, vital that the government takes action in the Budget on the EGL.

We have produced a paper that sets out our concern that the current EGL design will be perceived by investors as a super-tax rather than a genuine windfall tax.

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A well-designed and time-limited windfall tax that clearly, and fairly, targets excess revenues that have been made as a result of the current energy crisis (war in Ukraine, Putin's aggressive energy policy and Covid recovery) is justified, especially in the context of rising energy bills and government support for consumers. There are also some features of the UK EGL tax that are preferable to the EU equivalent, for example the minima and the fact that the EGL is a value share rather than a hard revenue cap.

However, we are concerned about the duration of the tax out to 2028 – well beyond the expected energy price crisis, and into a period when investors expect to see increasingly volatile prices for renewables. The duration of the tax raises the spectre that this may become a permanent feature, or at least one that could be readily applied again to penalise generators during periods of higher energy prices. Furthermore, the application of the tax to new generation projects that have not yet been built and have not generated excess profits over the past 18 months, seems wrong-headed.

In our paper we have made three key recommendations:

1) Remove future generation capacity built after 1st January 2023 from the tax. This must be the most obvious and reasonable policy change.
2) Reduce the duration of the tax, to at least bring it into line with the EU revenue cap, which we believe may be extended to 2025.
3) Allow new, or uplift existing investment allowances, to encourage targeted investment.

The effective marginal investment tax allowance for oil and gas sector companies paying the Energy Profits Levy is significantly higher (at over 109% or 91%) than for clean energy companies impacted by the EGL – see Appendix 1. Even without the disparity between clean energy companies and oil and gas, clean energy investors are already facing the imminent reduction in capital allowances owing to the withdrawal of Super-deduction and Special Rate allowances at the end of March 2023.

There are several options which could be considered for renewable generation and energy storage assets, for example:

- Keeping the 130% super-deduction (first year capital allowance) and extending this to all capital spend as part of a renewable energy project.
- Creating a new Enhanced Capital Allowance scheme regime for targeted assets.
- Increasing the annual investment allowance (AIA) from £1m to, for example, £20m.
- Extending 'writing down' allowances at 18% for all assets.
- Allowing greater flexibility around when allowances can be claimed against profits.
- Extending relief for R&D Expenditure Credit (RDEC) to encourage greater investment in innovation.

We also propose that, alongside reforming the EGL, the government should move rapidly to set out a net zero delivery plan and back that up by quickly expanding the Contracts for Difference (CfD) scheme, and other support mechanisms, to accelerate investment. In the current market and for the foreseeable future, new capacity added under the CfD scheme will reduce bills via the payback mechanism.

We understand that, at a time of high borrowing and spending pressure, the government needs to maintain tax revenue. However, we question the economic sense of squeezing out investment in critical low carbon energy assets, which will reduce the UK's energy import dependency and long-term energy costs, as well as stimulating growth.

We would be happy to discuss the contents of this letter in more detail with you and your officials.

Yours sincerely,

Johnny Gowdy
Director, Regen

cc. James Cartlidge MP, Exchequer Secretary to the Treasury
cc. Rt Hon Grant Shapps, Secretary of State for Energy Security and Net Zero
cc. Rt Hon Graham Stuart MP, Minister of State, DESNZ
cc. Freddie Wootton, Senior Policy Advisor, Corporation Tax
cc. Sarah Redwood, Director Renewable Energy Deployment DESNZ

## Appendix 1

**Tables showing the capital allowances available to companies which are subject to the Energy Profits Levy (EPL) compared to those subject to the Electricity Generator Levy (EGL) in relation to renewables investment expenditure.**

***Headline summary: The existence of different tax regimes, and in particular the more favourable capital allowances available to companies within the scope of the EPL, may influence an investor's decision. The 80% investment allowance for decarbonisation expenditure for EPL (which is not available for the EGL) is likely to materially improve the returns for companies within its scope.***

## Oil and Gas Companies Investing in Renewables

| Primary Direct Taxes | Tax Rate | Relief[1] | Amount of Relief on £100 Investment |
|---|---|---|---|
| **Ring Fence Corporation Tax (RFCT)[2]** | 30% | Enhanced (first year) capital allowance[3] – 100% | £30.00 |
| **Supplementary Charge (SC)** | 10% | Enhanced (first year) capital allowance – 100%<br>Investment allowance[4] – 62.5% | £10.00<br>£6.25 |
| **Energy Profits Levy (EPL)[5]** | 35% (as of 1st January 2023) | Enhanced (first year) capital allowance – 100%<br>**Investment allowance – 80% for decarbonisation expenditure or 29% for all other qualifying expenditure[6]** | £35.00<br>£28.00 or £10.15[7] |
| **Total** | **75%** | | **£109.25[8] or £91.40** |

[1] Note that capital / investment allowances continue annually on a reducing balance basis.

[2] The normal corporation tax regime is modified in its application to oil and gas producing companies in the UK and a 'ringfence' applies to prevent taxable profits from a company's UK oil and gas extraction business from being reduced by losses from other activities.

[3] This enhanced capital allowance – which upgrades the existing 25% plant and machinery allowance to 100% first-year allowance – is available in relation to each of RFCT, SC and EPL. Due to the availability of the enhanced capital allowance, the 130% super-deduction (see below) does not apply to expenditure on plant and machinery for the purposes of a ringfence trade. Enhanced capital allowances will be available for expenditure incurred on assets that are used for the purposes of a ringfence trade in respect of which SC is chargeable.

[4] This investment allowance can only be claimed once income is received from the field subject to the investment. The investment allowance operates by removing an amount equal to 62.5% of qualifying investment expenditure from a company's adjusted ringfence profits for SC purposes.

[5] The EPL will remain in place until 31 March 2028.

[6] Qualifying investment expenditure (which is defined as capital expenditure, operating expenditure or leasing expenditure that is incurred for the purpose of oil-related activities, not incurred for disqualifying purposes and does not consist of financing or decommissioning costs) benefits from an 80% relief. However, as part of the announcement in Autumn Budget 2022 to increase the rate of EPL to 35%, the investment allowance was also reduced from 80% to 29% for qualifying expenditure other than decarbonisation expenditure (defined as investment in carbon emissions-reducing technology). Electrification investment that decarbonises upstream oil and gas activities will qualify as decarbonisation expenditure for these purposes. This investment allowance, unlike the SC investment allowance, is available at the point of investment.

[7] 80% x 35% and 29% x 35%.

[8] The value of the tax relief for qualifying investment expenditure by ringfence companies can be up to 109.25% on the basis that companies will receive deductions (by way of capital and/or investment allowances) for RFCT, SC and EPL.

## Nuclear, Renewable and Biomass Electricity Generators Investing in Renewables

| Primary Direct Taxes | Tax Rate | Relief[9] | Amount of Relief on £100 Investment |
|---|---|---|---|
| **Corporation Tax** | Current (to 31st March 2023)<br>19% | Super-deduction (first-year capital allowance) – 130% (ending 31st March 2023)[10]<br>SR allowance[11] (first-year capital allowance) – 50% (ending 31st March 2023)[12]<br>(Annual Investment Allowance – 100%[13]) | £24.70<br>£9.50<br>£0[14] |
| **Corporation Tax** | From 1st April 2023<br>25% | Annual Investment Allowance – 100%[15]<br>Writing Down Allowances – 18%[16] | £25.00<br>£4.50 |
| **Electricity Generator Levy (EGL)[17]** | 45% | N/A[18] | N/A |
| **Total** | **70% (from 01st April 2023)** | | **Up to £29.50** |

[9] Note that capital allowances and investment allowances continue annually on a reducing balance basis.

[10] The super-deduction allows companies within the charge to CT to deduct 130% of expenditure on qualifying plant and machinery that would otherwise attract writing-down allowances (WDAs) at the main pool rate of 18% a year.

[11] The Special Rate (SR) allowance allows companies within the charge to CT to deduct 50% of the expenditure on qualifying plant and machinery that would otherwise attract WDAs at the special rate of 6% a year. Only one relief (i.e. SR allowance or super-deduction) can be claimed for each type of expenditure (unlike the position applying to EPL, where multiple reliefs can be stacked). Therefore, as with normal WDAs (at 18% or 6% on a reducing balance basis), it is important to identify whether plant and machinery expenditure is main pool expenditure or SR expenditure. SR expenditure includes expenditure on, amongst other things, solar panels and long-life assets.

[12] As of 01 April 2023, the super-deduction and SR allowance will no longer be available, and companies within the scope of the EGL will not have the benefit of any relief in relation to the 45% levy.

[13] The Annual Investment Allowance (AIA) provides a 100% relief for expenditure on plant and machinery up to a maximum annual limit (of £1m).

[14] Although the AIA is available alongside the SR allowance and super-deduction, generally the AIA is claimed against SR expenditure in priority to main pool expenditure to maximise allowances. Smaller businesses whose qualifying plant and machinery expenditure falls inside the AIA limit may prefer to exhaust the AIA before claiming temporary enhanced capital allowances including the super-deduction (which would trigger a balancing charge on disposal). For the purposes of this table it is assumed that there is no benefit to claiming the AIA in priority to the other allowances and so is ignored for these purposes.

[15] The AIA was made permanent in the Autumn Budget 2022 and the annual limit is currently £1m. Following the end of super-deduction and the SR allowance (31 March 2023) it will become increasingly valuable.

[16] This assumes that the plant and machinery expenditure is main pool expenditure (qualifying at 18% allowance) rather than lower rate (special rate) allowances at 6%.

[17] The EGL will remain in place until 31 March 2028.

[18] The current legislation governing the EGL does not (unlike the EPL) include any specific capital allowance for investments (although the company may benefit from the normal WDAs at 18% or 6% and the AIA). Companies within the scope of the EGL will be subject to the standard Corporation Tax regime plus a 45% levy (from 1 January 2023) on profits relating to extraordinary revenues above £75 per MWh (subject to an annual allowance of £10m).