TAXREP 13/99

CLIMATE CHANGE LEVY

Memorandum submitted in May 1999 to HM Customs and Excise by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation document issued in March 1999.

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GENERAL COMMENTS

1. We welcome the opportunity to comment on the proposals in the consultation document issued on 9 March 1999.

2. We are pleased to note that many proposed aspects of the climate change levy ('CCL') follow VAT rules so that, for example, information needs to be collated only once for both imposts. However, the complexity for the supplier of the matrix of VAT rules means that the VAT regime does not always work as well as it might, and in particular suppliers do not appear aways to be up to date with the status of their customers. Whilst it is important that no parties are disadvantaged, either the customer because the supplier is charging VAT or levy incorrectly or the supplier because the compliance burden is overwhelming, we are concerned that a desire for an unnecessary degree of precision will result in unnecessary complexity.

3. In formulating the detail of changes to the tax system and especially in designing any new levy we suggest that maxims on the lines of those put forward by Adam Smith, namely equity, certainty, convenience for the taxpayer and economy of collection, should be the guiding principles. A new tax is being born and the existence within the VAT regime of some of the bones, in particular the rules for the reduced rate of VAT on domestic fuel which have enabled various aspects to be road tested in advance to a certain extent, provides an opportunity to demonstrate how a real live tax could be developed which will satisfy Adam Smith's four principles.

4. Following these maxims is particularily important if it is desired that CCL is not to be perceived by businesses as yet another layer of burdensome red tape imposed by Government, the costs of administering which will be passed on to consumers on the ground that the NIC savings are insufficient. It is relevant also for smaller traders who, if some of the alternatives mooted in the consultation document are adopted, might be swept into the ambit of the tax seemingly by accident, such as retailers selling relatively small amounts of packaged fuels.

5. The Government's policy on environmental taxation is set out in Annex A of the consultation document. The first test is that environmental taxation must meet objectives without undesirable side effects. However, the proposed levy does seem to conflict with this as it imposes burdens on all businesses whether or not they are able to reduce their energy consumption.

DETAILED COMMENTS

Section 6: Calculation of the rate for electricity

Views would be welcome on how often a revision should be undertaken to reflect changes in the conversion factor

6. In order for the levy to maintain an incentive effect on the electricity generators to increase fuel efficiency, it does seem to be necessary for the conversion factor to be adjusted in line with any changes in the on-going ratio between fuel input and electricity use. Thus changes should be made as frequently as there is a significant

change in the underlying ratio. We suggest that the conversion factor be reviewed for changes at least annually.

Section 7: Distinguishing industrial/commercial from non-business use by charities and domestic use

Do you agree that the VAT model for fuel and power is a suitable model for distinguishing domestic use and non-business use by charities from other use?

7. In principle we favour following the VAT model for fuel and power as far as possible, to avoid the complexity of having a separate regime running in parallel for CCL. Modifications will be needed in practice, for example see the second paragraph of our answer to the following question.

Which method for dealing with businesses making supplies only to domestic consumers is preferable?

8. To relieve small businesses such as hardware stores, garage shops, etc of an administrative burden we suggest that they should be exempt from the levy, so that they are not obliged to file returns (even on a nil basis). We suggest that there should be a relatively straightforward exemption which would cover most businesses of this sort by reference to information which is readily available, such as the total annual supplies of fuel and/or the maximum size of the unit of supply (for example, a bag of coal).

9. One point that does need to be covered (and does not appear in the consultation document) is the supply of energy such as bags of coal or wood to small businesses such as hardware stores, garage shops, etc for onward sale in the same form to the domestic market. At present, sales by wholesalers to retailers of such fuels attract 17.5% VAT and the retailer charges only 5% VAT to domestic customers. For the purposes of CCL there will need to be a mechanism, preferably a form of self certification by the retailer, to enable the wholesaler to not charge the levy on such supplies.

Section 8: Public transport

Do you agree that the definition of public transport should mirror zero-rating for VAT purposes?

10. We favour following the VAT rules, in the interests of simplicity.

Are there any special issues to do with cross-border modes of transport?

11. There seem to be few special cross-border issues, if only because the main fuels used in transport are not subject to the levy.

Section 9: Use of energy as input to the production of another energy product

What processes do you think should qualify as fuel used for energy production? Do you envisage any difficulties in demonstrating that energy is being used for the production of another energy product? How might the quantity of energy used for production of other energy products be determined? Could it be done on a business sector basis? Are there any other alternatives?

12. We see no reason in principle why the distinction should be drawn between energy used directly as input to the production of another energy product and energy used, for example, for heating or lighting the offices of an energy producer. Either way, the energy is an input absorbed in the production of the secondary energy product, so the logic of avoiding a double charge should mean that it would be exempt. There are also strong arguments in terms of simplification for exempting all energy inputs to the primary producer, since this would avoid all the problems of distinguishing exempt and non-exempt inputs which are envisaged in this section of the document (except in cases where the producer is actually carrying on an entirely separate business as well, within the same corporate entity).

13. In theory generating companies ought to be subject to the levy on fuel used for lighting, heating, etc. However, if an electricity producer, for example, suffers the levy on energy which it uses to heat its own offices, this merely means that that charge will be built into the price of the electricity which businesses in other sectors purchase to heat their offices, and they will thereby suffer a double charge. There is no particular fairness in that, so we would suggest that the reference to ensuring fairness with comparable activities in other sectors seems to be misplaced

Section 10: Non-energy use of fuel products

What examples where fuel is used for non-energy purposes or has a dual use do we need to take into account? Are there particular circumstances in which establishing whether fuels are principally used for non-energy use will present difficulties? Would certification of non-energy usage by the final user work? What other alternatives are there?

14. These questions are best answered by the relevant industries. So far as the mechanics of the calculation are concerned, perhaps, in the interest of simplification, industry-by-industry standards could be negotiated which those in the industry could use or opt out of as appropriate depending on circumstances such as the abilty to measure respective usages.

Section 12: Arrangements for providing relief for particular uses

For each of the four cases for special treatment or relief listed in paragraph 12.1 above which option is preferable? How might they work in practice?

15. Option 1 seems greatly preferable, not only for the cashflow reason given but, where certification leads to exemption, because it greatly reduces the population of traders who are required to handle the tax (whether on payment or repayment). Certification by the customer seems unlikely to be any more onerous for him, or any harder to police for Customs, than actual claims for refund. It should be possible at least for a substantial proportion of cases to be handled relatively straightforwardly, where the customer is either wholly exempt or claiming relief on a fixed percentage

of use, by the customer lodging a certificate with his supplier on an on-going basis, subject to renewal perhaps once a year.

16. Inevitably there will be other cases where the customer's use of the fuel varies, or he does not have a permanent relationship with the supplier, when it will be necessary for him to provide a certificate with each purchase, and since there will no doubt be cases where even this is not practicable there would have to be the option of the customer claiming refunds after the event as a fall-back arrangement.

Section 13: Use of own produced fuel by energy producers

Do you agree with the self supply mechanism or is there an alternative method that would ensure levy was properly accounted for in these cases? How might the amount of self-supplied energy be verified?

17. As stated above, we do not agree with the principle of imposing the levy on fuel used by energy producers, whether self supplied or otherwise. The complexity of the suggested self supply mechanism underlines the inappropriateness of the concept.

Section 15: Renewables

Are there any ways in which energy suppliers could demonstrate that the electricity they supplied was from small-scale renewable sourses? Would they apply also to imported electricity?

18. We would have thought that it was simple enough in principle for an energy supplier to demonstrate that his electricity is all supplied from small scale renewable sources, if that is the case. The difficulty is in identifying this exempt supply (if it were indeed to be exempt) with any particular purchaser. Even if this could be done in some cases, the exemption would then seem to operate unfairly as between transactions where there is a supply direct to the final consumer and those where there is not. We believe that it is important to encourage renewables. However, if CCL is based on identifying the different types of consumer, then it will be a tax charged in relation only to outputs, and we can see difficulties in distinguishing between them. If a generator is selling fuel created solely from renewables, then one could make its supplies exempt - but this would lead to unfair competion with those generators who create energy from partly renewable and partly non-renewable sourses. All in all it seems much better not to try to define an exemption from CCL in these cases, but rather to support the renewables by other means.

Section 17: Community heating schemes

Do you agree with the proposed treatment of community heating schemes? What sort

of threshold might be appropriate? Might other safeguards be necessary to avoid distortion of competition?

19. The most logical approach would seem to be to treat community heating schemes on the same model as electricity generators, ie to treat the heat which they supply as a form of secondary energy product and exempt them on their energy inputs. However the traders concerned are much smaller than electricity generators, and whichever

method is used undoubtedly involves complexities. It does therefore seem very desirable to give them complete exemption provided their non-domestic supplies do not exceed a defined threshold. This could be expressed either in terms of an absolute amount or a proportion of total supplies. The former is probably more apt to let out the smaller schemes which would be the ones least well able to deal with the complexity of the levy.

Section 18: Imports/exports of energy

Do you agree with the treatment of imports and exports?

20. We consider that the proposed treatment of imports and exports is reasonable.

Section 19: Chargeable event and time of supply

Do you foresee any difficulties with using the VAT time of supply rules? How might a basic time of supply be expressed for continuous supplies of energy for no consideration?

21. Again, harmonisation with the VAT rules as far as possible seems desirable. In the case of continuous supplies for no consideration, the most practical way of finding a time of supply would seem to be by reference to a notional invoice issued at the end of each return period for the levy.

Section 20: Contracts and invoices

Should the amount of the levy be shown on invoices?

22. The incentive effect of the levy rests on the fact that it will increase the cost of fuel and therefore provide a stimulus to reduce energy usage. The levy should be shown on the face of the invoice as this is a good discipline, assists with accounting and will enable the customer (and Customs during a control visit) to check easily that the levy has not been charged where the customer is exempt.

Section 21: Registration

Is there anyone else who might be required to register for the levy?

23. The list of businesses likely to be required to register seems to be comprehensive.

Should group and divisional registration be available for energy suppliers?

24. Group registration should be allowed as a matter of administrative simplification. There is however a separate question as to whether the group should be treated as a single entity for all purposes of the levy, such that supplies of primary energy products between group companies would be ignored and supplies of secondary products be treated as self supplies. There is no straightforward answer to this question, since circumstances will differ: in some cases the relationship between the supplier and the customer will be essentially the same as between third parties, whereas in others the supply will be taking place within an integrated group where the

separation into separate corporate entities is almost accidental. On balance there is probably less risk of distorting competition if the group registration is administrative only and has no effect on the actual liability to the levy.

Section 23: Records

25. The proposition that anyone who makes a supply of energy on which they do not charge CCL should produce evidence of this will place too great a burden on those least able to cope with the administration and be impossible to meet for retailers who make cash sales without invoices to domestic customers.

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