Implications of expanded levies on energy producers

The Autumn Statement[1] and subsequent Finance Act 2023 increased the rate to 35 per cent (from 1 January 2023) and extended the duration up to 31 March 2028 of the energy (oil and gas) profits levy on profits from oil and gas production in the UK and the UK Continental Shelf (UKCS) (the oil and gas levy). As part of the Autumn Statement, proposals were also put forward for a separate electricity generator levy with the rate of 45 per cent on receipts from generating electricity from nuclear, renewable, biomass, and energy from waste sources in the UK (the electricity levy), effective from 1 January 2023 to 31 March 2028, but yet to be legislated. This note reflects on the effectiveness of these changes, including the background, mechanisms, and broader implications.

Background

The escalation of the Russo-Ukrainian War in February 2022 caused a drastic increase in oil and gas prices,[2] with unparalleled inflation[3] triggering the cost of living crisis.[4] In May 2022, the then Chancellor of the Exchequer, Rishi Sunak, extended the support package to tackle this crisis and announced a windfall tax, the oil and gas levy,[5] to offset costs associated with this further support. The initial version of this levy was discussed in "Shortcomings of Energy (Oil and Gas) Profits Levy" which reasoned that the oil and gas levy is a consequence of severe historical shortcomings in North Sea taxation with a convoluted system established from measures imposed to fill the short-term budget deficits. [6]

This was followed by unprecedented political turbulence with a chain of three prime ministers and drastic changes in the overall fiscal regime spanning from expansive tax cuts to tax rises in a period of only two months. Lizz Truss replaced Boris Johnson in September 2022.[7] Lizz Truss firmly argued against increases in windfall taxes.[8] During her premiership, the Chancellor of the Exchequer,

[1] HM Treasury, *Autumn Statement 2022* (2022) https://www.gov.uk/government/topical-events/autumn-statement-2022 [Accessed 5 December 2022].

[2] UK domestic gas prices increased by 129 per cent and electricity by 66 per cent. CPI (2015=100) of 99.4 for October 2021, CPI (2015=100) of 227.4 for October 2022: Office for National Statistics, "CPI INDEX 04.5.2: GAS 2015=100", *https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7du/mm23* [Accessed 7 December 2022]. CPI (2015=100) of 144 for October 2021, CPI (2015=100) of 238.6 for October 2022: Office for National Statistics, "CPI INDEX 04.5.1: ELECTRICITY 2015=100", *https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/d7dt/mm23* [Accessed 7 December 2022].

[3] The Consumer Prices Index including owner occupiers' housing costs rose by 9.6% in the 12 months to October 2022: Office for National Statistics, "Consumer price inflation, UK: October 2022" (17 August 2002), *https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/october2022* [Accessed 7 December 2022].

[4] Impact is summarised in several releases, including Brigid Francis-Devine et al, *Rising cost of living in the UK* (TSO, 2022), House of Commons Library Research Briefing, *https://researchbriefings.files.parliament.uk/documents/CBP-9428/CBP-9428.pdf* [Accessed 7 December 2022], or Iana Liadze et al, *The Economic Costs of the Russia-Ukraine Conflict* (London: National Institute of Economic and Social Research, 2022), NIESR Policy Paper 32.

[5] The Rt Hon. Rishi Sunak MP, Speech, *Cost of Living Support* (26 May 2022), *https://www.gov.uk/government/speeches/cost-of-living-support* [Accessed 5 December 2022].

[6] Karolis Matikonis "Shortcomings of Energy (Oil and Gas) Profits Levy" (2022) B.T.R.

[7] The Rt Hon Elizabeth Truss MP, Speech, *Prime Minister Liz Truss's statement (*6 September 2022), https://www.gov.uk/government/speeches/prime-minister-liz-trusss-statement-6-september-2022 [Accessed 5 December 2022].

[8] This was expressed during oral answers to questions to Prime Minister, available at: Parallel Parliament, Oral Answers to Questions Elizabeth Truss Excerpts (7 September 2022) https://www.parallelparliament.co.uk/debate/2022-09-07/commons/commons-chamber/oral-answers-to-questions [Accessed 7 December 2022].

Kwasi Kwarteng, delivered a Ministerial Statement entitled "The Growth Plan" to the House of Commons of the United Kingdom,[9] with expansive tax cuts primarily funded through borrowing.[10] The immediate response to this statement was prominent, with protests across the country,[11] the value of the pound sterling falling,[12] and the Bank of England prompting an emergency gilt buyout[13] after the unprecedented for a developed country criticism from the International Monetary Fund.[14] This triggered the resignation of Liz Truss, who was replaced by Rishi Sunak in October 2022.

Rishi Sunak pledged to "place economic stability and confidence at the heart of this Government's agenda."[15] The strategy switched from borrowing to reduce taxes, to increasing taxes to reduce borrowing. The new Chancellor of the Exchequer, Jeremy Hunt, presented an Autumn Statement which reversed nearly all the measures announced in "The Growth Plan" and instruments to reduce borrowing, including the introduction of the electricity levy and expansion of the oil and gas levy.[16] The forecasted collections were mainly reliant upon the expansion in the windfall taxes, with these two levies alone forecasted to account for 43 per cent of collections from new instruments between 2022-23 and 2027-28.[17]

Although both levies share similar objectives, the existing fiscal regime for oil and gas extraction differs from electricity generation, resulting in distinct challenges for their implementation.[18] The fiscal regime for oil and gas extraction operates a "ring-fence" principle.[19] Ring-fence isolates the extraction of gas and oil from other activities, preventing taxable profits from oil and gas extraction from being reduced by losses from other activities or by interest payments. The oil and gas levy can thus be based on the design of the existing instruments that oil and gas producers

---

[9] HM Treasury, *The Growth Plan 2022* (TSO, 2022), p.25, *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1105985/HMT_Autumn_Statement_2022_PRINT.pdf* [Accessed 7 December 2022].

[10] This is summarised in Carl Emmerson and Isabel Stockton "Reversing NICs and corporation tax rises would leave debt on an unsustainable path" (London: Institute for Fiscal Studies, 2022), IFS Report R217, *https://ifs.org.uk/sites/default/files/2022-09/Reversing-NICs-and-corporation-tax-rises-would-leave-debt-on-an-unsustainable-path-Final-R127.pdf* [Accessed 7 December 2022].

[11] Several news articles reported on protests, for example in Megan McEachern "Protests against cost-of-living crisis and Government's mini-budget to take place across UK this weekend" (2022) *The Sunday Post, https://www.sundaypost.com/fp/enough-is-enough-protests-against-cost-of-living-crisis/* [Accessed 7 December 2022].

[12] The dip in value was captured by media, for instance in BBC "Pound hits record low after tax cut plans" (2022) *https://www.bbc.co.uk/news/business-63030208* [Accessed 7 December 2022].

[13] Bank of England "Bank of England announces gilt market operation" *https://www.bankofengland.co.uk/news/2022/september/bank-of-england-announces-gilt-market-operation* [Accessed 7 December 2022].

[14] The statement from International Monetary Fund and its brief evaluation is available in Natalie Sherman and Tom Espiner "IMF openly criticises UK government tax plans" (2022) *BBC* https://www.bbc.co.uk/news/business-63051702 [Accessed 5 December 2022].

[15] The Rt Hon Rishi Sunak MP, Speech, *Prime Minister Rishi Sunak's statement (*25 October 2022) https://www.gov.uk/government/speeches/prime-minister-rishi-sunaks-statement-25-october-2022 [Accessed 5 December 2022].

[16] HM Treasury, *Autumn Statement 2022* (2022) https://www.gov.uk/government/topical-events/autumn-statement-2022

[17] Author's calculation with data from HM Treasury, *Table 5.1 Autumn Statement 2022 Policy Decisions* (2022) https://www.gov.uk/government/publications/autumn-statement-2022-documents#:~:text=Table%205.1%20Autumn%20Statement%202022%20Policy%20Decisions,-MS%20Excel%20Spreadsheet [Accessed 5 December 2022].

[18] This was also acknowledged in official documents, starting with HM Treasury "Policy paper Energy Profits Levy Factsheet - 26 May 2022" (2022) https://www.gov.uk/government/publications/cost-of-living-support/energy-profits-levy-factsheet-26-may-2022 [Accessed 5 December 2022].

[19] CTA 2010 Pt 8 Chs 3, 3A, 4.

are ordinarily liable to pay, namely ring-fence corporation tax charged at 30 per cent[20] and supplementary charge at 10 per cent. [21]

The fiscal regime for electricity generation does not include the ring-fence principle, making the implementation of a windfall tax more challenging. Electricity generators follow the standard corporation tax rules, including deductibles and reliefs that allow offsetting taxable profits from electricity generation by losses from other activities or by interest payments. They also pay standard corporation tax at 19 per cent, or 25 per cent with profits in excess of £250,000 from 1 April 2023.[22] These complexities involved in the design of the electricity levy resulted in different timeframes for legislation. At the time of writing, the oil and gas levy amendments are already legislated with Finance Act 2023, whilst only draft legislation is available for the electricity levy.[23] These documents are primarily used when discussing the mechanisms in the following sections.

Amendments to energy (oil and gas) profits levy

The oil and gas levy was introduced with the Energy (Oil and Gas) Profits Levy Act 2022, effective from 26 May 2022. It imposed an additional 25 per cent levy on profits from oil and gas production in the UK and UKCS from 26 May 2022. It is charged in addition to ring-fence corporation tax and supplementary charge and broadly follows the same principles with some exceptions, including companies being unable to offset previous losses against profits subject to the oil and gas levy. Its more detailed mechanisms and shortcomings have already been discussed in "Shortcomings of Energy (Oil and Gas) Profits Levy"[24] with the main issues arising from its temporal nature and marginal collections limited by generous allowances and reliefs.

Finance Act 2023 legislated three major changes to the Energy (Oil and Gas) Profits Levy Act 2022. The rate of the oil and gas levy was increased from 25 per cent to 35 per cent starting from 1 January 2023,[25] and it was extended to 31 March 2028. The same provisions were included in terms of the "straddling periods" with one more cut-off point of 31 December 2022. The levy should be charged at 25 per cent between 26 May 2022 and 31 December 2022 and at 35 per cent onwards. For the straddling period, the profits or losses for the oil and gas levy should be apportioned separately from other taxes between these periods as if they were separate accounting periods on a just and reasonable basis.[26]

The investment allowance was reduced from 80 per cent to 29 per cent,[27] except for decarbonisation.[28] Although investment allowances are now lower than those offered by supplementary charge at 62.5 per cent, they are unlikely to have a substantial effect on increasing collections. For example, a company operating in oil and gas extraction making £50 million taxable profits would be liable to pay £32.5m in ring-fence corporation tax, supplementary charge and oil and gas levy before the uplift in oil and gas levy and £37.5m afterwards. Assuming that it invests all £50m

---

[20] CTA 2010 s.279A.

[21] CTA 2010 s.330.

[22] HM Revenue & Customs "Corporation Tax charge and rates from 1 April 2022 and Small Profits Rate and Marginal Relief from 1 April 2023" (2022) https://www.gov.uk/government/publications/corporation-tax-charge-and-rates-from-1-april-2022-and-small-profits-rate-and-marginal-relief-from-1-april-2023 [Accessed 5 December 2022].

[23] Electricity Generator Levy [Draft as of 20 December 2022]

[24] Karolis Matikonis "Shortcomings of Energy (Oil and Gas) Profits Levy" (2022) B.T.R.

[25] FA 2023 s.1(1).

[26] Energy (Oil and Gas) Profits Levy Act 2022 s.17.

[27] FA 2023 s.2(1).

[28] The investment allowance for investment expenditure on upstream decarbonisation is planned to remain at 80 per cent but it was not legislated with FA 2023. For instance, this intention is expressed in HM Treasury "Policy paper Energy Taxes Factsheet" (2022) https://www.gov.uk/government/publications/autumn-statement-2022-energy-taxes-factsheet/energy-taxes-factsheet [Accessed 12 December 2022].

in further extraction, under the new regime its allowance to offset future profits would be reduced from £10m to £5.1m. However, the company would still get full relief from ring-fence corporation tax, supplementary charge and oil and gas levy as a first-year capital allowance and an additional £3.1m in investment allowance for supplementary charge once investment starts generating income – a total tax relief of £45.7m.

The lifespan of the oil and gas levy has now been increased to six years, but the restriction of the ability to carry losses and profits backwards or forward by only one year still exists, keeping a relatively limited window to offset the profits with allowances, especially given that the effects of investments are likely to take time. Having said that, the extension of the timeframe reduced issues on how capital gains will be treated, but this could still be an issue for some organisations as they encompass all future profits, so those beyond the end of the oil and gas levy are likely to be subject to this levy. Similarly, the repayments from Petroleum Revenue Tax, which is a historical tax still generating receipts, are not exempt from the oil and gas levy, so it is imposed on repayments from when companies were not experiencing unprecedented profits.

Introduction of electricity generator levy

A prominent new feature in the Autumn Statement is the electricity levy, which is expected to be included in the Spring Finance Bill 2023.[29] Although it has already been costed with expectations of a consistent stream of tax receipts, totalling over £14bn during its existence,[30] the technical note[31] published together with this data offered only an ambiguous description of its mechanisms that were further explained on 20 December 2022 with a publication of the draft legislation,[32] explanatory note[33] and supplementary technical note.[34] The levy will apply from 1 January 2023 to 31 March 2028[35] to electricity generated from nuclear, renewable, biomass, and energy from waste sources, excluding electricity generated from gas, coal and oil. It affects groups and standalone companies connected to a national grid or local distribution networks that produce more than 50 gigawatt-hours per annum of electricity, reduced proportionately if the qualifying period is less than 365 days.[36] This is a decrease from 100 gigawatt-hours in the initial technical note. [37]

The relatively small pool of taxpayers is exposed to a complicated tax regime built on taxing aggregate receipts. The electricity levy of 45 per cent seems to superficially mimic the overall rate of taxation of oil and gas extractors, especially once the corporation tax rate on profits is lifted to 25 per

[29] The intention was noted in HR Revenue & Customs "Policy paper Electricity Generator Levy on exceptional electricity generation receipts" https://www.gov.uk/government/publications/electricity-generator-levy/electricity-generator-levy-on-exceptional-electricity-generation-receipts [Accessed 28 January 2023].

[30] Author's calculation with data from HM Treasury, *Table 5.1 Autumn Statement 2022 Policy Decisions* (2022) https://www.gov.uk/government/publications/autumn-statement-2022-documents#:~:text=Table%205.1%20Autumn%20Statement%202022%20Policy%20Decisions,-MS%20Excel%20Spreadsheet [Accessed 5 December 2022].

[31] HM Treasury "Electricity generator levy technical note" (2022) https://www.gov.uk/government/publications/electricity-generator-levy-technical-note [Accessed 12 December 2022].

[32] Electricity Generator Levy [Draft as of 20 December 2022]

[33] HM Treasury "Explanatory Note" (2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1126015/Explanatory-note.odt [Accessed 27 December 2022].

[34] HM Treasury "Electricity Generator Levy: supplementary technical note" (2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1125818/Electricity_generator_levy_December_update__2_.pdf [Accessed 27 December 2022].

[35] Electricity Generator Levy [Draft as of 20 December 2022] s.1(9).

[36] Electricity Generator Levy [Draft as of 20 December 2022] s.1(4).

[37] HM Treasury "Electricity generator levy technical note" (2022) https://www.gov.uk/government/publications/electricity-generator-levy-technical-note [Accessed 12 December 2022], 1.22.

cent with profits in excess of £250,000 from 1 April 2023.[38] Instead of profits as in the oil and gas levy, the electricity levy is applied on exceptional generation receipts at an aggregate level across all in-scope generations of the group in respect of a qualifying period aligned to the accounting period of the company. They are, however, calculated by deducting generated electricity set at a benchmark price of £75 per megawatt-hour, allowable costs and the £10m allowance from the receipts of the undertaking that are within the scope of the levy.[39]

Little reasoning for setting the £10m allowance[40] was provided in the documentation, and the benchmark price of £75 per megawatt-hour[41] was justified as fair only because it is "considerably higher than the average wholesale electricity price in the decade up to 2021."[42] In terms of benchmark price, further detail was added in the draft legislation that from the financial year ending in 2025, the benchmark price would adjust based on the 12-month consumer prices index in December.[43] The concern, however, is that none of the other fixed values, for instance, the £10m allowance, will be indexed. This could have severe implications, especially considering the recent drastic movements in the customer price index.[44]

For most companies, generation receipts will be the amount received from third parties for its generation output from wholesale purchases of that output for that period. If a company sells on wholesale market terms with no further sale of the output, the amounts are those received by the companies within the group.[45] As a simplified example, take a company which is not part of the group and has £100m per annum on generation receipts from selling on wholesale market terms, of which £70m per annum relates to the benchmark price of £75 per megawatt-hour with no allowable deductions for the purpose of the electricity levy. It has operating costs of £30m and finance costs of £20m. For corporation tax, it would be liable to pay a 25 per cent rate[46] on receipts with deductions of operating and finance costs, resulting in a tax liability of £12.5m. After the introduction of the electricity levy, it would have to pay a further 45 per cent on £20m once the allowance of £10m is deducted from the receipts in excess of £75 per megawatt-hour. The electricity levy, in this case, would total £9m and, thus raise the actual tax liability of the company by 72 per cent.

However, the estimation of tax liability for the electricity levy becomes more complicated for groups with more comprehensive structures or more diverse value creation from the generation, in particular when companies in the group act as the interface with the market and/or those that have responsibility for hedging. Receipts should align with the timing of revenue recognition for financial

---

[38] HM Revenue & Customs "Corporation Tax charge and rates from 1 April 2022 and Small Profits Rate and Marginal Relief from 1 April 2023" (2022) https://www.gov.uk/government/publications/corporation-tax-charge-and-rates-from-1-april-2022-and-small-profits-rate-and-marginal-relief-from-1-april-2023 [Accessed 5 December 2022].

[39] Electricity Generator Levy [Draft as of 20 December 2022] s.1(5).

[40] Electricity Generator Levy [Draft as of 20 December 2022] s.1(6).

[41] Electricity Generator Levy [Draft as of 20 December 2022] s.2(1).

[42] HM Treasury "Electricity generator levy technical note" (2022) https://www.gov.uk/government/publications/electricity-generator-levy-technical-note [Accessed 12 December 2022], p. 10.

[43] Electricity Generator Levy [Draft as of 20 December 2022] s.2(2).

[44] The Consumer Prices Index including owner occupiers' housing costs rose by 9.6% in the 12 months to October 2022: Office for National Statistics, "Consumer price inflation, UK: October 2022" (17 August 2002), *https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/october2022* [Accessed 7 December 2022].

[45] Electricity Generator Levy [Draft as of 20 December 2022] s.4(1),4(2).

[46] Corporation tax on profits will be lifted to 25 per cent with profits in excess of £250,000 from 1 April 2023, as per HM Revenue & Customs "Corporation Tax charge and rates from 1 April 2022 and Small Profits Rate and Marginal Relief from 1 April 2023" (2022) https://www.gov.uk/government/publications/corporation-tax-charge-and-rates-from-1-april-2022-and-small-profits-rate-and-marginal-relief-from-1-april-2023 [Accessed 5 December 2022].

reporting purposes, irrespective of when these arrangements were entered.[47] The fair and reasonable basis and arms' length provision, in case of transfer pricing as defined in Part 4 of TIOPA 2010,[48] are often used in draft legislation to attribute the amounts. For instance, in terms of generation receipts, the fair and reasonable basis is defined as the attribution to reflect the amount realised for the wholesale purchase of electricity from that generation.[49] Only a few things are specified that should be taken into account so far: a settlement code in connection with accepted offers to increase generation, imbalance charges under such a code, as well as payments and receipts from hedging.[50] The section on generation receipts also includes ambiguous subsections that the Treasury may make further provisions when amounts could be attributable to generation[51] or treated and not treated as generation receipts.[52]

The allowable costs include exceptional generation fuel costs, exceptional revenue-sharing costs of generating stations and qualifying electricity purchase costs.[53] The latter is limited to only purchasing electricity to meet contractual agreements,[54] with a further ambiguous provision "…other descriptions of costs as may be specified in regulations made by the Treasury." [55] Similarly to receipts, these costs are on the arms' length, in the case of transfer pricing as defined in Part 4 of TIOPA 2010,[56] and need to be attributable to generating for the qualifying period, fairly and reasonably attributable to receipts, reflect expenses and be not already reflected in receipts.[57]

Complex methodologies to calculate the exceptional generation fuel costs and exceptional revenue-sharing costs are provided in Clauses 6 and 7. For instance, to estimate exceptional generation fuel costs, companies are required to compare the actual generation fuel costs, including costs related to transportation and acquiring fuel naturally, in the period with the baseline fuel costs.[58] They should be consistent with the basis on which actual costs for the qualifying period are determined[59] and lesser than £65 per megawatt-hour,[60] with no indexing equivalent to the benchmark price.

Significant attention in the draft legislation is also dedicated to the definitions and rules of allocating receipts and liabilities between groups, minority and majority shareholders, partnerships, and joint ventures[61] that generators, funds, and limited recourse funders should carefully consider. Having said that, the inclusion of an anti-avoidance section in the draft legislation,[62] with similar wording as in other tax legislation, should limit any attempts at tax avoidance through unjustified corporate restructuring, contracts for differences or behind-the-meter supply arrangements.

In terms of administration, the electricity levy follows existing corporation tax rules, including self-assessment, penalties and payment.[63] The main difference is that within a group

[47] Electricity Generator Levy [Draft as of 20 December 2022] s.4(1),4(2).
[48] Electricity Generator Levy [Draft as of 20 December 2022] s.4(7)-(8).
[49] Electricity Generator Levy [Draft as of 20 December 2022] s.4(2).
[50] Electricity Generator Levy [Draft as of 20 December 2022] s.4(3), 4(4).
[51] Electricity Generator Levy [Draft as of 20 December 2022] s.4(5).
[52] Electricity Generator Levy [Draft as of 20 December 2022] s.4(6).
[53] Electricity Generator Levy [Draft as of 20 December 2022] s.5(1).
[54] Electricity Generator Levy [Draft as of 20 December 2022] s.5(6).
[55] Electricity Generator Levy [Draft as of 20 December 2022] s.5(1)(d)
[56] Electricity Generator Levy [Draft as of 20 December 2022] s.5(4)(b)
[57] Electricity Generator Levy [Draft as of 20 December 2022] s.5(2).
[58] Electricity Generator Levy [Draft as of 20 December 2022] s.6(1).
[59] Further provisions in terms of period are provided in Electricity Generator Levy [Draft as of 20 December 2022] s.6(4), s.6(5).
[60] Electricity Generator Levy [Draft as of 20 December 2022] s.6(3).
[61] Electricity Generator Levy [Draft as of 20 December 2022] s.8-16.
[62] Electricity Generator Levy [Draft as of 20 December 2022] s.22.
[63] Electricity Generator Levy [Draft as of 20 December 2022] s.17-21.

exceeding the 50 gigawatt-hours threshold, the lead member will be responsible for the payment of the electricity levy on behalf of the group, but all members are jointly and severally liable for the electricity levy.[64] Other group members can also be nominated in many circumstances.[65] Further provisions will likely be introduced around this by the Treasury,[66] and guidance for taxpayers is expected to be published in 2023.[67]

Broader implications

Fiscal stability is associated with higher investment and greater tax revenues.[68] The frequently changing fiscal regime increases investor risks by creating risk premia, especially high when economic conditions are weaker[69] and, in this way, reduces future investment.[70] The recent political turbulence is likely to transfer to increased long-term uncertainty from changes to levies that reinforced the concerns[71] of the fiscal regime of oil and gas production in the UK and the UKCS. Instead of establishing carefully curated long-term fiscal policy for energy production, the Government rushed[72] to extend and impose windfall taxes. Balancing books was favoured over the careful optimisation of tax receipts in the way of not discouraging further activity, which was found to be the case even before these changes, especially in terms of shale gas extraction.[73]

The North Sea fiscal regime became even more convoluted with a design focused on shorter-term budget deficits instead of long-term prospects. This is particularly evident from the new lifespan

---

[64] Electricity Generator Levy [Draft as of 20 December 2022] s.10.

[65] Electricity Generator Levy [Draft as of 20 December 2022] s.9, 18(4).

[66] Electricity Generator Levy [Draft as of 20 December 2022] s.9(4)

[67] HM Treasury "Electricity Generator Levy: supplementary technical note" (2022) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1125818/Electricity_generator_levy_December_update__2_.pdf [Accessed 27 December 2022], 1.113.

[68] For instance, Norway, which is also operating in the North Sea, has stuck to a combined rate of 78 per cent for oil and gas extraction since 1992. The already high combined rate required no adjustments to capture the exceptional profits. The Norwegian higher combined rate did not just result in higher collections but also did not deter investment. On the contrary, it continuously outperformed UK. In 2020 it had over three times greater extraction and more than twice higher tax collections per tonne even when excluding the collections from State's Direct Financial Interest, as discussed in Karolis Matikonis "Shortcomings of Energy (Oil and Gas) Profits Levy" (2022) B.T.R.

[69] For instance, Pastor and Veronesi find that political uncertainty commands a risk premium in terms of stock market. This premium is particularly high when economy is weak in L. Pastor and P. Veronesi, "Political uncertainty and risk premia" (2013) Journal of Financial Economics 110, 520-545.

[70] Political instability has long been known to reduce foreign direct investment, as explained in Kamal Fatehi-Sedeh and M. Hossein Safizadeh "The Association between Political Instability and Flow of Foreign Direct Investment" (1989) *Management International Review*, 29(4), 4-13.

More recently, Sabir et al show that government effectiveness, political stability and regulatory quality among other factors have a greater effect on foreign direct investment in developed countries, in: Samina Sabir, Anum Rafique and Kamran Abbas, "Institutions and FDI: evidence from developed and developing countries" (2019) *Financial Innovation*, 5.

[71] These were expressed after the initial introduction of the oil and gas levy in Karolis Matikonis "Shortcomings of Energy (Oil and Gas) Profits Levy" (2022) B.T.R.

[72] The oil and gas levy was introduced rapidly, with the consultation running merely five working days, as in HMRC, Draft legislation: Energy (Oil and Gas) Profits Levy Bill (2022). There were no consultations in relation to the extension of the oil and gas levy.

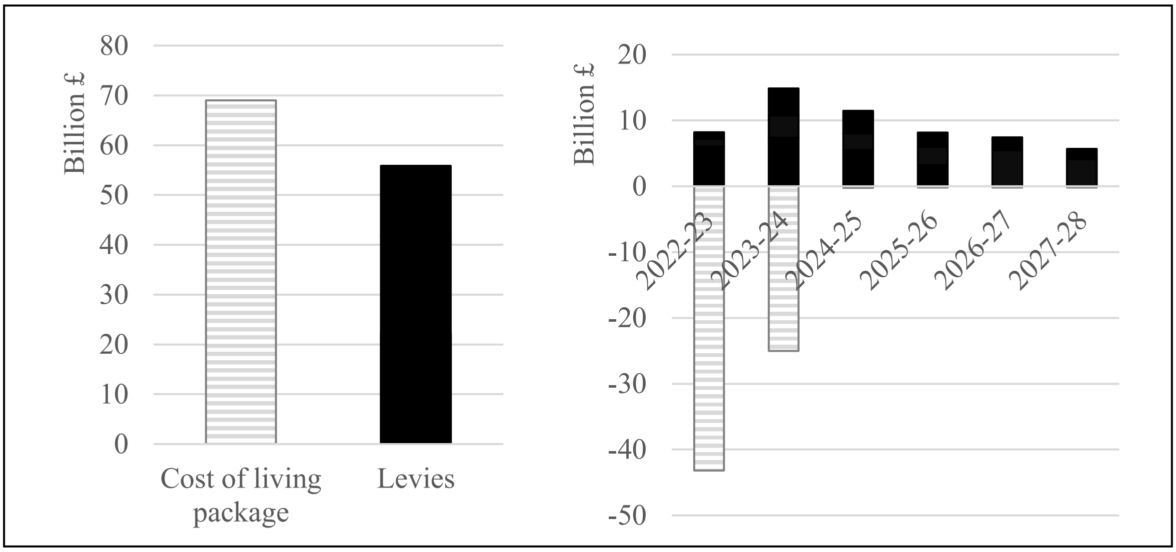
In terms of electricity generator levy, there were no formal consultation and stakeholders were only invited to discuss the levy over email once the technical note was published: HM Treasury "Electricity generator levy technical note" (2022) https://www.gov.uk/government/publications/electricity-generator-levy-technical-note [Accessed 12 December 2022].

[73] Acquah-Andoh et al attribute the slow development of shale gas extraction in the UK to the fiscal regime that, they argue, does not offer sufficient protection enabling extraction during lower gas prices in E. Acquah-Andoh, O. Ike, A. O. Ifelebuegu, and A. Owusu "The fiscal regime for UK shale gas: Analysing the impacts of pad allowance on shale gas investments" (2020) Energy Policy, 146.

of the instruments, which appears to be more motivated by painting a picture of decreasing the fiscal deficit than exceptional profits. The Chancellor of the Exchequer stated "no objection to windfall taxes if they are genuinely about windfall profits caused by unexpected increases in energy prices" but extended the levies until the end of March 2028 with no intention to phase out the oil and gas levy, unlike in the previous version of the oil and gas levy.[74] It is unclear why the duration of exceptional profits is supposed to last up to the end of March 2028. Similar assumptions did not seem to be imposed regarding the support with the Energy Price Guarantee, the costliest instrument from the cost of living package, which was extended only for a further 12 months and at a higher threshold.

This is illustrated in Figure 1 below. From the first sign of the illustration with data from the Autumn Statement in the stacked column chart on the left, it seems that the collections from windfall taxes nearly offset the cost of living support with a shortfall of £13 billion. This is, however, unlikely, as illustrated in the chart on the right, which shows annual costs associated with the cost of living package and forecasted tax receipts from windfall taxes between 2022-23 and 2027-28. From these costings, we could incorrectly imply that the energy producers would be experiencing exceptional profits up to 2027-28, but the customers will only need support up to 2023-24. If customers do not need support post-2023-24, the energy producers are unlikely to have exceptional profits, so taxing them seems unjust.

Figure 1: Forecasted Expenditure for the Cost of Living Package against Collections from Windfall Taxes (Left) and Annual Trends between 2022-23 and 2027-28 (Right) in Billion £[75]



[74] Although the removal of the sunset clause from the Energy (Oil and Gas) Profits Levy Act 2022 is yet to be legislated, the intention to do so was expressed in documentation: "The government will also no longer consider phasing out the levy ahead of its end date of March 2028" in HM Treasury "Policy paper Energy Taxes Factsheet" (2022) https://www.gov.uk/government/publications/autumn-statement-2022-energy-taxes-factsheet/energy-taxes-factsheet [Accessed 12 December 2022].

It is also worth noting that there are clear rules in terms of electricity generator levy with the automatic exclusion from electricity generator levy when the sale price is less than £75 per MWh, adjusted based on the 12-month consumer prices index from the financial year ending in 2025.

[75] Writer's construction. Data source: HM Treasury, *Table 5.1 Autumn Statement 2022 Policy Decisions* (2022) https://www.gov.uk/government/publications/autumn-statement-2022-documents#:~:text=Table%205.1%20Autumn%20Statement%202022%20Policy%20Decisions,-MS%20Excel%20Spreadsheet [Accessed 5 December 2022].

Furthermore, the changes are inconsistent with the longer-term international commitments related to meeting the net zero target by 2050.[76] Although an attempt has been made to incentivise oil and gas producers to invest in decarbonisation during the expansion of the oil and gas levy, the investment allowances are still built to incentivise the investment in continuing the extraction of oil and gas in favour of renewable energy, despite all the commitments the Government has made, including ending inefficient fossil fuel subsidies by 2025.[77] This is evident from the generous capital allowances extending to the oil and gas levy but not the electricity levy. The companies that invest in the continuous extraction of oil and gas would not have to pay the oil and gas levy, but those that invest in renewable energy would still be liable to pay the electricity levy.

These allowances and reliefs are likely to contribute to limiting tax receipts. Although the receipts are likely to increase, even after the expansion of windfall taxes, it is still doubtful whether the current design of the oil and gas levy has a sufficiently high potential to offset costs related to the support for the cost of living crisis. The extent of the collections could be much lower than the forecasted £56bn, considering the generous reliefs and allowances for both oil and gas extraction as well as renewable energy generation. The stacked bar chart on the left of Figure 2 below shows how tax collections compare to the most prominent reliefs and allowances in the North Sea taxation regime, including a 100 per cent first-year allowance for capital spending for ring-fence corporation tax and supplementary charge, a further 62.5 per cent investment allowance from supplementary charge and various field allowances aimed to incentivise investment in more difficult-to-extract fields and substantial reliefs for decommissioning fields.[78] The value of reliefs and allowances has exceeded tax collections every year in consideration. The contribution from electricity generators is also likely to be lower given that they have historically paid lower overall taxes than oil and gas extractors, as indicated in the line chart on the right of Figure 2. The unjustified £10m allowance and the relatively high benchmark price of £75 per megawatt-hour further amplify these concerns regarding the electricity levy.

It is, however, worth noting that the future collections and exact effects of windfall taxes are difficult to estimate with currently limited empirical data. Although there have been studies investigating the impact of various windfall taxes in the UK and abroad with primarily adverse results,[79] the structure of each of these taxes differed. This makes any attempt to generalise from

---

[76] Department for Business, Energy and Industrial Strategy, Department for Environment Food & Rural Affairs, *Policy Paper—G7 Climate and Environment: Ministers' Communiqué, London, 21 May 2021* (TSO, 2021), *https://www.gov.uk/government/publications/g7-climate-and-environment-ministers-meeting-may-2021-communique/g7-climate-and-environment-ministers-communique-london-21-may-2021* [Accessed 27 September 2022].

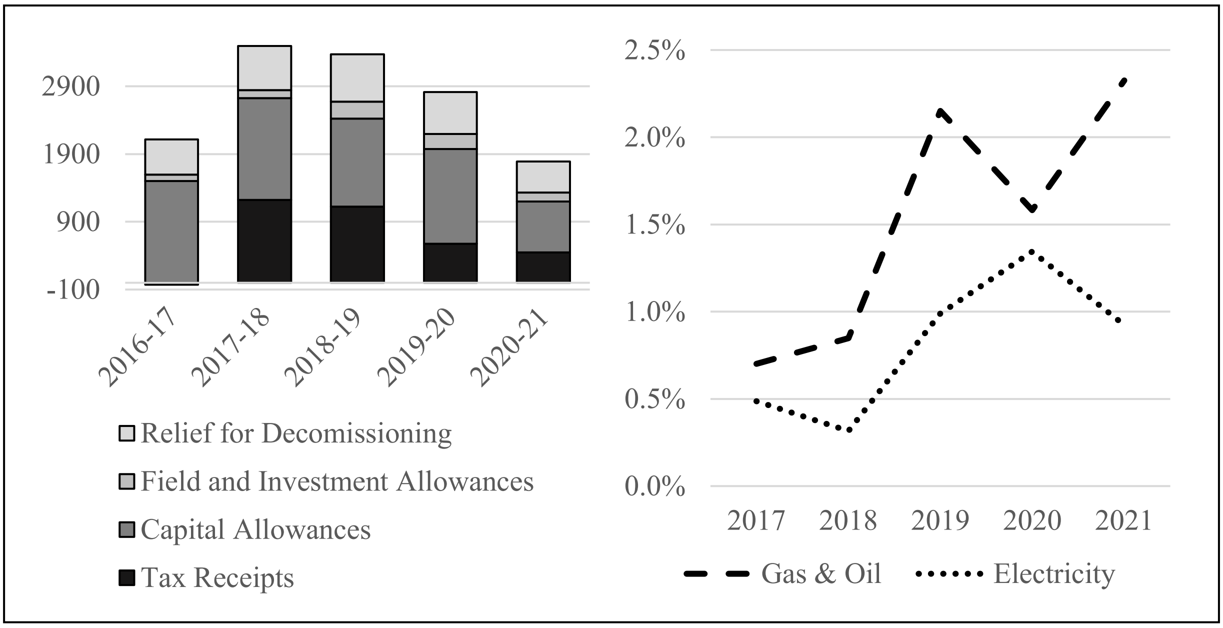
[77] These intentions were specified in Department for Business, Energy and Industrial Strategy, *Consultation on the guidance for the Subsidy Control Act 2022* (TSO, 2022), para.399, *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1087647/subsidy-control-act-2022-guidance-consultation.pdf* [Accessed 27 September 2022].

[78] For more detailed discussion on decommissioning, see Hafez Abdo and Jane Frecknall-Hughes, "UK Tax Policy in the Oil and Gas Sector: An Empirical Examination of Recent Changes" [2022] B.T.R.

[79] For instance, the assessments of the most recent UK windfall tax imposed to offset gains form privatisation of utility companies in 1997 refer to primarily adverse results: Antoniou et al find the lack of actual abnormal results, Waelde and Kolo further suggest that risks corresponded to returns, Chennells finds that the tax was unfair and may result in reputation damage and Tickell comments on employment losses, in: Thomas W. Waelde and Abba Kolo, "Renegotiating Previous Governments' Privatization Deals: The 1997 U.K. Windfall Tax on Utilities and International Law" (1999) 19(3) *Northwestern Journal of International Law & Business* 405; A. Antoniou, D.G. Barr and R. Priestley, "Abnormal stock returns and public policy: the case of the UK privatised electricity and water utilities" (2000) 5 *International Journal of Finance and Economics* 93; Lucy Chennells, "The Windfall Tax" (1997) 18(3) *Fiscal Studies* 279; Adam Tickell, "A Tax on Success? Privatization, Employment and the 'Windfall Tax'" (1998) 30(1) *Area* 83.

previous implementations challenging. This is echoed by mixed opinions from experts and stakeholders.[80]

Figure 2 Proportion of Allowances to Tax Receipts from Ring-fence Corporation Tax and Supplementary Charge in Million £ (Left)[81] and Taxation to Turnover Ratio Among Gas and Oil Extractors and Electricity Generators (Right)[82]



Conclusions

The political turbulence and frequent changes in the fiscal regime are likely to lower investors' confidence and thus contribute to lower investments in energy generation in the longer term. This is

[80] The opinions are well summarised in Anthony Seely, *Taxation of North Sea Oil and Gas* (TSO, 2022), House of Commons Library Research Briefing, *https://researchbriefings.files.parliament.uk/documents/SN00341/SN00341.pdf* [Accessed 7 December 2022].

[81] Writer's construction. The figure firstly appeared in Karolis Matikonis "Shortcomings of Energy (Oil and Gas) Profits Levy" (2022) B.T.R. Note that the estimates do not include capital allowances that generate taxable losses which can be carried forwards or backwards against profits from other years or surrendered as group relief. Some figures have been calculated by HMRC using company returns data: HMRC, *Non-structural reliefs cost estimates* (TSO, 2022), *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1046800/non_structural_cost_estimates_tables_december_2021.ods* [Accessed 27 September 2022]; North Sea Transition Authority, "Table: Estimated cost of upstream oil and gas tax reliefs in recent years" (10 December 2021), *https://www.nstauthority.co.uk/media/7900/estimated_cost_of_reliefs_december_2021.pdf* [Accessed 12 September 2022]; Office for Budget Responsibility, *March 2022 Economic and fiscal outlook—charts and tables: Executive summary* (2022), Chart 3.7.

[82] Writer's construction. Only companies that reported taxation expenditure were kept in the sample. Data for 2022 was limited and therefore excluded from the visualisation. This resulted in 561 observations from electricity producers with standard industrial classification (2007) code of 3511 and 335 observations from crude petroleum and natural gas extractors with standard industrial classification (2007) code of 06. Data source: Bureau van Dijk. Forecasting, Analysis and Modelling Environment (2015) https://www.bvdinfo.com/en-gb/our-roducts/data/national/fame?gclid=Cj0KCQiAkMGcBhCSARIsAIW6d0D4ptCr7WZY3Qpq4VBlD3Gq8gMjSGhjCsJQyf1M-D26Bh2APh1X0iIaAvdIEALw_wcB [Accessed 12 December 2022].

further amplified by the Government's focus on balancing its budget instead of optimising long-term tax receipts in the way of not discouraging further activity, which is evident by the hasty introduction of levies. This rush to introduce new tax instruments resulted in some technical concerns that could have been avoided by using carefully debated and possibly even retrospective instruments. Although minor attempts have been made, the levies do not seem to align with the international commitments in relation to reducing carbon emissions, especially in terms of offering generous allowances to companies liable to the oil and gas levy but not the electricity levy. These changes only further accentuate the lack of a coherent, well-thought-out fiscal regime for oil and gas production in the UK and the UKCS, whose flaws seem to be spreading to the fiscal regime of electricity generators. There is ample potential to solve these issues through the ongoing reviews of electricity market arrangements[83] and long-term tax treatment of the North Sea.[84]

Karolis Matikonis*

[83] The first stage of this review is now completed, as per Department for Business, Energy & Industrial Strategy "Review of electricity market arrangements" (2022) https://www.gov.uk/government/consultations/review-of-electricity-market-arrangements [Accessed 12 December 2022].

[84] The review is to be completed by the end of 2023, as mentioned in HR Treasury "Energy Taxes Factsheet" (2022) https://www.gov.uk/government/publications/autumn-statement-2022-energy-taxes-factsheet/energy-taxes-factsheet [Accessed 12 December 2022].

* Lecturer at Queen's Management School, Queen's University Belfast.