The changing tax environment

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Jayne Harrold and Colin Smith consider the development and implementation of new environmental taxes

Key Points

What is the issue?

Tax has become an important policy lever in helping to drive behavioural change. The development and implementation of new environmental taxes means that more businesses will start to fall within their scope.

What does it mean for me?

Management of environmental taxes by taxpayers frequently relies on detailed and granular operational data. The data often needs to be collated from multiple sources and can be difficult to obtain, manage and verify, with wide scope for misunderstanding or error.

What can I take away?

The strong movement towards the development of new environmental taxes, such as plastic packaging tax, will bring more businesses within their scope, meaning that more tax teams may need to start managing them for the first time.

With the increased public profile of environmental issues, particularly plastic pollution and climate change, tax has become an important policy lever in helping to drive behavioural change. The development and implementation of new environmental taxes means that more businesses will start to fall within their scope.

The EU Green Deal published in December 2019 sets out a number of proposals including a new plastic packaging levy which will take effect from 1 January 2021 and consultation on a carbon border adjustment mechanism to apply carbon pricing in some form to imported goods.

The purpose of this article is to explore UK environmental taxes, including the new plastic packaging tax which takes effect from 1 April 2022, and carbon emissions tax which may replace the EU Emissions Trading Scheme from 1 January 2021.

We have set out the detail of the current UK environmental tax regime so that tax teams who may not be interacting and dealing with these taxes get a sense of some of the challenges that they could face if they deal with these or the new environmental taxes in the future.

What are the environmental taxes?In 2012, HM Treasury defined environmental taxes as those meeting the following three principles:

- the tax is explicitly linked to the government’s environmental objectives;
- the primary objective of the tax is to encourage environmentally positive behaviour change; and
- the tax is structured in relation to environmental objectives, e.g. the more polluting the behaviour, the greater the tax levied.

We focus in this article on the core indirect environmental taxes: landfill tax, aggregates levy, climate change levy, the proposed carbon emissions tax which may be implemented with effect from 1 January 2021 if a UK Emissions Trading Scheme cannot be implemented, and plastic packaging tax which will take effect from 1 April 2022.

Common features

As for many of the indirect taxes and excise duties, environmental taxes tend to be levied at a single point in the supply chain.
Although a relatively small number of taxpayers are required to levy such taxes and complete tax returns, a much larger number of businesses bear the economic burden of such taxes as part of the cost of waste disposal services, aggregate (rock, sand and gravel), gas and electricity, and in future on the cost of plastic packaging.

The new plastic packaging tax will impact a much greater number of taxpayers than the existing environmental taxes, meaning that tax teams may need to start managing environmental taxes for the first time. There are commonalities between the taxes that mean the lessons learned from management of the existing environmental taxes can be directly applied.

All of the environmental taxes are designed to introduce a price signal into the supply chain to promote alternative, less environmentally damaging, behaviour by making alternative options more economically viable. For example, increasing the cost of waste disposed to landfill not only changes the market price for disposal, making investment in recycling infrastructure more economically viable; it also improves the business case for investment in waste reduction measures at source.

Management of environmental taxes

Management of environmental taxes by taxpayers frequently relies on detailed and granular operational data. The data often needs to be collated from multiple sources and can be difficult to obtain, manage and verify. There can be wide scope for misunderstanding or error, which can lead to tax disputes.

> The environmental taxes are designed to introduce a price signal into the supply chain to promote less environmentally damaging behaviour.

Operational teams more often than not have control of the creation and management of these data sources. Tax teams managing existing environmental taxes have learned to work closely with operational and legal teams to ensure that robust processes and controls are implemented and maintained to manage tax risks appropriately.

Plastic packaging tax#

The new plastic packaging tax is due to take effect from 1 April 2022. The tax will be charged at £200 per tonne on plastic packaging which contains less than 30% recycled content.

In the latest publication of draft legislation (see bit.ly/2JqrS0U) and summary of response to consultation (see bit.ly/36sBMrK), the scope of the proposed tax has been extended. The number of taxpayers will be much greater than for any of the existing environmental taxes.

Plastic packaging tax will potentially affect any business which:

1. manufactures or imports plastic packaging components; or
2. imports packaged goods into the UK.

The term ‘plastic packaging components’ is important. Under the draft legislation, the meaning of the term is much broader than might first be thought. As well as the obvious natural meaning, it is also defined as products ‘designed to be used solely or mainly by a user or consumer for the transportation, storage or preservation of goods’.

This means that many actual plastic products themselves will also fall within the scope of the tax. The potential scope is so wide that in the summary of response to consultation, the government notes that some products not intended to be captured

could fall within the definition because they provide some kind of containment, giving an example as a plastic handbag. Secondary legislation and guidance are to be issued to help clarify the scope, but given the potentially very wide application it will be important for any business dealing in goods to follow developments and assess whether they fall within the scope of the tax.

Impact for tax teams

Collating the information to comply with the requirements for evidence of both quantities of plastic packaging material and levels of recycled content will be fairly onerous.

Tax teams will have to liaise with operational teams to identify the data sources that already exist and any systems changes required to collect data that does not currently exist. Importantly, this need for data and reporting will apply whether the tax is due or not. Even if all plastic packaging contains 30% or more recycled content, affected businesses will need to register and complete returns, and robust evidence of recycled content will be required on a component by component basis at production run level of detail.

Carbon emissions tax

From 1 January 2021, the UK will no longer be within the EU Emissions Trading Scheme (EU ETS). Energy intensive facilities which are currently within the EU ETS will need to comply with the new domestic regime which will take the form of either a UK Emissions Trading Scheme or a carbon emissions tax.

At the time of writing, the government has not confirmed which scheme is to take effect, but whichever applies it will relate to emissions during calendar year 2021 in any event, with compliance obligations in 2022.

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Impact for tax teams

Both proposed domestic schemes are intended to broadly mirror the EU ETS but there are some subtle differences that may impact affected facilities, including the need to reconsider transfer pricing arrangements.

Landfill tax

Landfill tax (LfT) is charged on waste disposed of at landfill sites in England and Northern Ireland. It is a devolved tax so there are separate regimes in Wales (landfill disposals tax) and Scotland (Scottish landfill tax). There are two rates of LfT, the standard rate which is currently £94.15 per tonne and the lower rate which is currently £3.00 per tonne.

The taxpayer for LfT is the landfill site operator and returns are required to be filed quarterly. Although this is a small number of businesses, the economic burden of LfT or the effect it has on disposal prices for alternative waste disposal routes is borne by waste producers. It can be difficult for waste producers to know what LfT amounts they bear within their costs because it tends not to be tracked and will be entered into ERP systems as part of the net figure.

For a waste producer the key issues to consider are:

1. appropriate management of waste streams to reduce the amounts being sent to landfill;
2. properly segregate and avoid contamination of materials that qualify for the lower rate of tax; and
3. identify any exemptions and reliefs that may apply.

Lower rate materials are those listed in the Landfill Tax (Qualifying Material) Order 2011 in England and Northern Ireland. (The equivalent legislation in Wales is Landfill Disposals Tax (Wales) Act 2017 Schedule 1; and in Scotland is The Scottish Landfill Tax (Qualifying Material) Order 2016.) They are generally inert materials with low pollution potential such as rock, soil, concrete, certain minerals, slags, ash and low activity inorganic compounds. There are prescriptive requirements with regard to what does and does not qualify for the lower rate and this is an unusual area of tax in being subject to legal directions from the tax authorities made within published guidance. It is an area that is subject to intense scrutiny from the tax authorities.

Exemptions from LfT are for very limited activities like dredging, mining and quarrying waste, pet cemeteries(!), and the filling of certain quarries.

Of much wider application, water discounts are available for a number of industrial activities involving the addition of water during the process or for transportation of waste.

Impact for tax teams

It is the waste producer who applies to HMRC for a water discount agreement, with the consent and agreement of their landfill site operator. The agreement acts to reduce the amount of LfT charged on every tonne of the specified waste disposed by the agreed percentage of added water contained within the waste. The agreement is issued subject to a number of conditions in order for it to continue to apply, and there is a requirement to let HMRC know if there is a change in the amount of water present in the specified material. HMRC has been applying increased focus on compliance with water discounts by waste producers recently.

For many years, LfT was only due when waste was disposed of at a landfill site. As a measure to increase the financial consequences of unauthorised waste disposal activity, LfT is now applied to unauthorised disposals in each of the LfT regimes. Examples of circumstances that might accidentally trigger a charge to tax include:

- temporary storage of material exceeding the required time limits due to operational or permitting issues (one year where material is destined for disposal or three years where material is destined for recovery or treatment);
- non-compliance with the terms of an exemption from a requirement to hold a waste permit (thus triggering an unfulfilled requirement to hold a permit);
- developments under the Definition of Waste: Development Industry Code of Practice in which unexpected material is found during the course of the development; and
- material deposited by someone else on your land.

Given that material movement and management is an operational issue, it can be difficult for tax teams to be aware of activities taking place within the business which might unintentionally trigger a liability. It is important for tax teams to ensure that operational, commercial, legal and real estate teams which may undertake relevant activities are aware of the consequences and risks, and ensure that they are aware that they should consult with the tax team if in doubt.

Joint and several liability can extend liability up the supply chain to any party who knowingly caused or knowingly permitted the unauthorised disposal to take place. Of particular note, land owners are automatically considered to be jointly and severally liable unless they can show that they took all reasonable steps to ensure the disposal did not take place.

Aggregates levy

Aggregates levy (AGL) is charged at £2 per tonne on the commercial exploitation of aggregate which is broadly defined as rock, sand and gravel. Generally, it is a commercial quarry operator that is responsible for registering for and charging the tax, but others can be liable too.

There are a number of exemptions and reliefs from AGL available to end users. In essence, these exemptions and reliefs are aimed at circumstances where aggregate is not being used for construction purposes. Exempt processes include, for example, creating dimension stone, extracting industrial minerals, producing lime or cement from limestone and certain uses of shale.

The most common reliefs for end use are for use of material in industrial and agricultural processes prescribed by the Schedule to the Aggregates Levy (General) Regulations 2001.

Impact for tax teams

For tax teams, as well as ensuring that available exemptions and reliefs are claimed for use of material, it is important to be aware of activities within the business that might trigger an obligation to register and account for AGL. These ancillary activities have given rise to a number of tax disputes over the years with regard to whether AGL is due or not. Whilst these disputes have frequently been found in favour of the taxpayer, the time and cost associated with a tax dispute can be significant.

Construction of buildings or construction work on other large scale assets can be an activity that might trigger a need to assess whether tax is due. For the construction of buildings, there is an AGL exemption for aggregate removed from the site of the proposed building exclusively for the purpose of laying its foundations, pipes or cables.

Ostensibly, this is a fairly narrow exemption and work on building sites can involve more extensive works, including reprofiling activities which might trigger a liability. In Customs and Excise Commissioners v East Midlands Aggregates Ltd [2004] BTC 8107, the High Court rejected a narrow interpretation of the meaning of the site of the proposed building and allowed aggregate removed from the site of a lorry park serving the warehouse being built to benefit from the buildings exemption.

For large scale projects such as construction or repair of reservoirs, roads, pipelines and wind farms, there may be a requirement for locally sourced aggregate to be used to reduce the environmental impact of a project which can result in the need for tax teams to assess whether a liability to register is triggered or not. The issues can be complex and have been tested before the Tribunal in Hochtief Ltd [2009] TC 00264 and Northumbrian Water Ltd [2015] BTC 511.

AGL could become the subject of devolution in the way that LfT has. Devolution has not occurred to date due to a long running State Aid investigation and litigation which only recently ended. Reform of AGL is currently being considered.

Climate change levy

Climate change levy (CCL) is a tax on supplies of fuel to business customers. There are two rates:

1. the main rate which is charged on supplies of gas, electricity and some other commodities made to business customers; and
2. the carbon price support rate which is paid by electricity generators on supplies of gas, LPG or coal or other solid fossil fuels they use for electricity generation.

The main CCL taxpayers are licensed gas and electricity suppliers and electricity generators using fossil fuels for electricity generation. Other activities can trigger a liability, including operation of combined heat and power plants. As for the other environmental taxes, whilst there are a small number of taxpayers there are a large number of end consumers who bear the economic burden of CCL via their energy bills.

As an end consumer, there are a number of exemptions and reliefs from climate change levy which may be available. Businesses within certain energy intensive industries may enter into a climate change agreement in return for entering into the agreement, which includes energy efficiency targets, a discount of 92% on CCL charged on electricity and 81% on CCL charged on gas, rising to 82% from 1 April 2022 (see bit.ly/3ogeAmr for a list of sectors with climate change agreements).

Impact for tax teams

These exemptions and reliefs have to be claimed, generally through submission of two forms: a form PP10 which is sent to HMRC; and form PP11 which is sent to the

energy supplier. The energy supplier then directly applies the exemption or relief to their charges.
Much like VAT and partial exemption calculations, any claim for exemption or relief to be applied is based on retrospective figures. It is not known at the time what the actual relief should be and there may be a need for adjustment later. For any business claiming exemption or relief through forms PP10 and PP11, there is an obligation to review actual entitlement to relief against relief received on an annual basis and to make an adjustment if there is a difference. If too much relief has been claimed, the business may need to register for CCL in order to account for it to HMRC.

Summary

Whilst the current UK environmental taxes have a narrow taxpayer base, there are a number of potential risks and opportunities for tax teams to be aware of. The strong movement towards the development of new environmental taxes, such as plastic packaging tax, will bring more businesses within their scope, meaning that more tax teams may need to start managing them for the first time.

It will be important for tax teams to monitor developments and stay connected with the wider business in order to assess the impact, manage risk, implement processes and controls to comply with new requirements and identify opportunities.