

Going green

An ecological frame of mind can save your tax bill. PAUL WEBB explains how.

THE RECENT UN conference in Bali on climate change, held just after the release of the report by its IPCC agency (the Intergovernmental Panel on Climate Change), will leave us in no doubt as to the seriousness of the current state of global warming and what can be done to stop the Earth from overheating. And this is yet more proof to add to the already mounting evidence from last year's *Stern Report* (<http://snipurl.com/sternrev>) that unless we act now by investing 1% of our global gross domestic product, global warming could shrink the world economy by 20%.

Big business has already 'upped its game' with widely-publicised corporate social responsibility strategies and ambitious targets for carbon emission reductions. In many cases these initiatives are as much about public relations and reputation management as they are about actually seeking to make a difference. But as long as they show a positive impact, does the primary motivation really matter?

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The issue now is how to encourage businesses of all sizes to follow suit. There are a number of schemes available aimed at giving businesses tax breaks for making so-called 'green investments'. Yet research published just a few weeks ago by Bristol Business School and Smith & Williamson highlighted that just 5% of businesses are taking advantage of environmental tax breaks. Their report also went on to say that these low take up rates are the result

KEY POINTS

- The background to rewarding green business investment.
- The cost of the climate change levy.
- Enhanced capital allowances for energy-saving investments.
- What qualifying technologies are eligible for relief?
- Calculating the relief available.
- Should the Government be doing more?



of poor awareness of the existence of such schemes (50%), and, among those that were aware, a sizeable number said they found the procedures involved too complex (13%).

Green rewards

It is true that more needs to be done to simplify the structure of green tax relief schemes and calls are being made from a number of sources seeking to activate the government to reward businesses going in the right direction with greater incentives. In the meantime, we need to work with what is currently available, and help to guide clients through the opportunities available.

There are a number of areas where small and medium-sized enterprises (SMEs) in particular can claim up front tax relief by 'going green'. Aside from the scientific and moral arguments in favour of becoming more environmentally friendly, smaller businesses can improve their bottom lines and in some cases, also create a useful option for employee remuneration as I will outline in my article.

Climate change levy

Since April 2001 and the original introduction of the climate change levy, businesses have been taxed according to the amounts of energy consumed, in a bid to improve energy efficiency and reduce greenhouse emissions. Its stated aim is to reduce carbon dioxide emissions by at least 2.5 million tonnes of carbon per year by 2010. The tax is based on the use of energy in industry, commerce and the public sector, with offsetting cuts in employers' National Insurance contributions and additional support for energy efficiency schemes and renewable sources of energy.

Box. Climate change levy rates

Rates from 1 April 2007:

- 0.441p/kWh (pence per kilowatt-hour) for electricity.
- 0.154p/kWh for gas.
- 1.201p/kg (pence per kilogram) for any other taxable commodity, e.g. coal.
- 0.985p/kg for liquefied petroleum gas (LPG).

Rates from 1 April 2008:

- 0.456p/kWh for electricity.
- 0.159p/kWh for gas.
- 1.242p/kg for any other taxable commodity, e.g. coal.
- 1.018p/kg for LPG.

In practice, the levy is applied at different rates, depending on the energy content of the different sources used. For example, see the **Box** above.

Electricity is taxed at a higher tax rate because a considerable proportion of the energy content of the fossil fuels used to generate the electricity is lost in combustion, transmission and distribution. Petrol and diesel, and road fuel gases, mineral oils and waste and other renewable energy sources are not taxable commodities.

Logically, by reducing energy consumption, businesses and organisations can reduce the impact of this tax. But in reality, the levy has proved very expensive for many businesses. The Government has recognised that the levy could severely impede the international competitiveness of certain energy-intensive sectors and so is allowing an 80% discount from the levy for certain sectors that, in return, agree challenging targets for improving their energy efficiency or reducing carbon emissions.

In addition, it is possible for businesses to claim upfront tax relief when investments in the right kinds of energy-saving equipment are made.

Enhanced capital allowances

Enhanced capital allowances for energy-saving investments were originally introduced by FA 2001 and – with the addition of the environmentally beneficial plant and machinery legislation introduced in FA 2003 – businesses can claim enhanced capital allowances (ECAs) and gain 100% tax relief during the period of acquisition. This is available for companies which either spend or invest money on energy-saving plant and machinery, regardless of size, industry sector, or geographical location. It can be very valuable for an organisation by delivering a cash flow boost, offsetting the cost of the climate change levy, and also helping to recoup the costs of refitting or re-building premises.

There are three sub-category schemes for ECAs:

- Energy-saving plant and machinery.
- Low carbon dioxide emission cars and natural gas and hydrogen refuelling infrastructure.
- Water.

On the whole, the enhanced capital allowances legislation is a good scheme, and relief can be claimed for both corporation and income tax. But the Government has been very prescriptive about what it allows. For instance, tax relief can only be claimed on fixtures and fittings, not the structural elements of a building.

There are also some exclusions and certain expenditures which do not qualify for ECAs. Obviously, any investments prior to 1 April 2001 are not covered, but additional ineligible situations include instances where expenditure was incurred on pre-used or second-hand plant or machinery.

The other main criterion states that under most general circumstances, expenditure must also not be excluded by the general rules for first-year allowances (CAA 2001, s 46), for example, because it is expenditure on cars, ships, railway assets and, for expenditure incurred before 17 April 2002, on assets for leasing, letting or hire. However, FA 2003, s 167 and Sch 30 amended the rules in general exclusion 6 of CAA 2001, s 46(2) so that it is now possible to qualify for first-year allowances (FYAs) on energy-saving and environmentally beneficial plant and machinery which has been leased on or after 17 April 2002 or before 31 March 2006.

To appreciate the terminology distinctions, broadly speaking ‘plant’ refers to the apparatus used in a business, and is distinct from the premises from where business is carried out. Cars with low emissions purchased on lease after this date also qualify for FYAs.

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Qualifying technologies

In terms of what items are eligible for purchase, there are currently 16 qualifying technologies plus certain types of plant or machinery that meet the government’s key energy saving criteria (CAA 2001, Part 2). Expenditure on plant and machinery is extended to include other direct costs such as the transportation of this equipment to site and installation charges.

To summarise, the different categories are, investments made in combined heat and power (CHP), boilers, lighting, pipe insulation, motors, variable speed drives and thermal screens since April 1 2001 are eligible. Since August 2002, refrigeration equipment, heat pumps for space heating, radiant and warm air heaters, solar thermal systems and compressed air equipment have been eligible. Automatic monitoring and targeting equipment was added for August 2003 and the latest technologies to be included since August 2004 were air to air energy recovery equipment, compact heat exchangers and heating, plus ventilation and air conditioning zone controls.

It is important to note that other conditions apply and further research into each situation would be necessary

Example 1

A business purchases production machinery for £80,000, which includes a qualifying energy-saving motor.

The value attributed to the motor is £20,000 and a further £5,000 is needed for installation. Capital allowances can be claimed as follows:

- £20,000 qualifies for 100% FYA under the scheme for energy-saving investments.
- 25% would be treated as writing down allowances on the balance (£60,000) plus installation at £5,000. This amounts to £65,000 at 25% = £16,250.
- Therefore the total allowances for the period are £20,000 + £16,250 = £36,250.

before advising clients on ways to offset their investments. For instance, certain technologies, e.g. combined heat and power (CHP), (which can be used to recycle otherwise wasted energy), must be certified as 'good quality CHP' under the CHPQA (quality assurance) scheme. To achieve this status, the installation needs to be completed according to a pre-specified energy technology criteria list and inspected for final certification.

First-year allowances

Expenditure on lighting equipment and pipe insulation is eligible for 100% first-year allowances (FYAs) provided that the items in question meet the designated energy-saving criteria, as outlined in the energy technology criteria list.

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In some cases where items do not fully qualify, the overall cost may be apportioned on an item by item basis to distinguish aspects of the total expenditure which are eligible. Overall, procedures for these types of technology are less bureaucratic in that neither the product nor the installation needs to be separately certified.

For all other types of technology listed by HMRC, i.e. boilers, motors, heat pumps, solar systems, etc, expenditure only qualifies if the products purchased are included in or recognised by the energy technology product list. This is an important point to stress with clients, because they will not be eligible to claim 100% FYAs if the product in question is not on the relevant product list – even if it meets the energy-saving standards specified for its technology category.

See www.eca.gov.uk/etl for more details.

Proportionate claims

A case might also arise where a client may purchase an item of machinery which forms a component part of a larger piece of equipment. In these situations, relief can be claimed on a proportion of the item, based on its qualifying components (CAA 2001, s 45C). The purchase price is apportioned to calculate the amount eligible for FYAs, but the normal rules for apportionments in CAA 2001, s 562 do not apply in these cases. **Example 1** illustrates how the apportionment of expenditure on energy saving components can work.

If – in **Example 1** – the payment was not incurred in one go and was made in instalments, then the benefit of the FYAs is to be spread across the instalments. In these situations, it is necessary to calculate the proportion of the total cost qualifying for 100% FYAs and apportion across the instalment payments. There are other exceptional situations where, for example, a larger piece of plant or machinery was acquired together with other assets. In these instances, the amount relating to the energy-saving investment must be apportioned using CAA 2001, s 562 and s 45C to find out firstly how much is attributable to the larger item and then, how much of the consideration qualifies for ECA.

New premises and cars

Another point worth considering for clients relates to the purchase of new business premises. In these cases, if clients were to consider purchasing one of the new breed of 'eco-friendly' premises off-plan, for instance, within a new 'green development', they would be able to specify energy-saving fixtures and fittings and then still be eligible for enhanced capital allowances. This can prove a good option in the right circumstances.

The second area where companies can benefit from ECAs is through purchasing low emissions cars. This covers new cars with carbon dioxide emissions of not more than 120gm per kilometre driven for use in their business. It also covers investments made in natural gas and hydrogen refuelling equipment at refuelling stations.

The availability of the ECAs means that it is essentially possible to buy a £10,000 car for net cost of £7,000. There are not that many cars that fall into this very low emissions category, but the Toyota Prius favoured by Hollywood celebrities and also Smart cars are two well-known examples of cars that do.

Buying low emissions cars can also work very well as an employee benefit. Give an employee a £10,000 car, and he will be taxed on only 15% of the value; i.e. £1,500. If he is a 22% rate taxpayer then it will cost him only £330 a year in tax. By having the employee pay for all his own business fuel and reclaim mileage at the approved rates, it may be possible to reduce that figure even further.

From April 2008, the calculations are even more appealing. The 15% rate will fall to only 10% and so it will cost the employee only £200 a year.

Cars which do not qualify as low emission vehicles will, from 6 April 2008, be eligible for a 2% reduction in the applicable emissions percentage if they run on bioethanol (E85) fuel.

Water conservation

The final category included under the ECA scheme is for investment made in the conservation of water. This covers purchase of items such as flow controllers, meters, leakage detection equipment, more efficient toilets and taps, plus rainwater harvesting equipment.

There are many more aspects of this legislation to be aware of and, as is no doubt becoming apparent to readers, the qualifying criteria can be time consuming for clients to go through independently. It is therefore little wonder that Smith & Williamson's research has shown complexity is proving to be a prohibitive issue for some.

Making the case

As is almost universally proposed by industry, there needs to be much more of a carrot rather than a stick approach to environmental management. There is much more the Government could do to encourage UK businesses to be more environmentally friendly. And it would make a real difference.

Businesses need to be rewarded generously for good practice and emissions trading offers one solution which could form a key part of the longer-term solution to greenhouse gas emissions. This would allow companies to emit in excess of their allocation of allowances by purchasing additional allowances from the market. Similarly, a company that emits less than its allocation of allowances can sell its surplus allowances.

In Germany, the most energy-efficient town in Europe has a council that gives its businesses real incentives for going green. These include reduced council tax and big tax breaks on solar panels. If the UK Government could learn from that town and shift its emphasis from punishment to reward then there is no reason why, before too long, the most energy-efficient town in Europe could not be British.

However, while Government incentives are important, there is much else that should persuade businesses to take a closer look at their carbon emissions. For one thing consumers are becoming ever more concerned by green issues and taking them into account when making purchases.

This is also a filtering through to the procurement departments of large companies, and it is now common for them to demand evidence of energy efficiency from potential suppliers.

Finally though, the most compelling argument for any company to go green is that our emissions are destroying our climate.

We may not have to face the results, but if the IPCC, Sir Nicholas Stern and the overwhelming majority of the world's scientists are correct, then our children and grandchildren will be facing dire consequences. We can protect their futures by acting now. ■

Paul Webb is a tax partner at the Robert James Partnership, winners in the Best Tax Team in a Smaller Firm category of the 2006 Taxation Awards and finalists in 2007. For more information visit www.rjp.co.uk.