

Tax briefing note

Climate change levy

June 2025

What is it?

The climate change levy is a tax levied on most non-residential users of most forms of energy. It was introduced in 2001 as part of the government's climate change programme. Users can participate in climate change agreements which reduce liabilities by anywhere from 77 per cent for liquified petroleum gas to 92 per cent for electricity. Eligibility for these agreements is based on the energy intensiveness of the activity and the extent of import penetration into the UK market. Exemption from the levy for electricity produced from renewable sources was abolished in 2015. The rate for gas rose to reach parity with the rate for electricity in 2024. The rates are frozen in 2025 but will rise by 3.3 per cent in 2026 for gas, electricity and other taxable commodities, except LPG which will remain frozen.

What's the problem with it?

The climate change levy is bureaucratic, incoherent and distortionary.

Bureaucratic

Climate change agreements require energy users to meet certain criteria (set on a sectoral basis). These agreements privilege energy use in activities which are intensive and competitive across national borders. The intention is to ameliorate the destructive distortionary effects of the levy but the reluctance to use a price mechanism instead of regulatory compliance reveals the problem with the levy itself.

Incoherent

The levy was introduced as a measure to address climate change. But it is charged on energy consumption rather than emissions and is even charged on renewable electricity use. Solid fuel use is charged at a lower rate than gas, measured by emissions and electricity is charged at the same rate regardless of the source. Some activities are also covered by both the UK emissions trading scheme (and its EU predecessor) and the climate change levy. This means that emissions saved by the climate change levy will not affect total emissions but instead simply transfer to other activities.^{1,2} Finally, it applies only to non-residential use instead of all use, despite residential use for heating already benefitting from the reduced rate of VAT.

Distortionary

Because it does not apply equally to all users of energy, the climate change levy distorts economic activity away from uses which are liable in favour of uses which are not liable (such as residential use in the UK, or industrial use outside the UK). It also distorts activity away from low-energy to high-energy use, even though the objective is to reduce emissions not energy use.

What should be done?

Abolish the climate change levy, leaving the UK emissions trading scheme to address emissions policy.

¹ HMRC allude to this in their policy paper on the removal of the renewable exemption from the CCL, 'no direct impact on the achievement of UK Carbon Budget targets, as emissions from electricity generation are capped through the EU Emissions Trading System'.

² HM Revenue & Customs, Climate Change Levy: removal of exemption for electricity from renewable sources, 8 July 2015, quoted in: Seely, A & Ares, E., Climate Change Levy: renewable energy & the carbon reduction commitment, House of Commons Library, 20 April 2016, p. 9.