Thank you for your letter dated 4 June, on behalf of the Business, Energy and Industrial Strategy Committee, regarding concerns over the policy landscape in which the small-scale renewables industry, including solar, is currently operating.

I wrote to you on 7 June regarding our plans for the launch of the Smart Export Guarantee (SEG) which ensures that small-scale low-carbon generators will be able to sell their excess electricity back to the grid. On 10 June, I was pleased to be able to set out our final policy on the SEG in an update to Parliament, and lay legislation in the House. I have set out answers to your questions below.

1. When was BEIS first made aware of this potential change in VAT treatment?

In 2015, the Court of Justice EU (CJEU) found that the scope of the UK’s reduced rate for Energy Saving Materials was inconsistent with EU law, and the UK Government was therefore required to amend the scope of the relief. Following the judgement, the Government responded on 9 December 2015 with an HMRC consultation on proposals to revise the VAT policy, which proposed to remove the reduced rate for solar panels in its entirety. The solar industry expressed concerns regarding this proposal, and officials therefore engaged in further discussions with the European Commission, with the aim of maintaining as much of the relief as possible while still complying with the CJEU decision. Following these discussions, revised proposals were published by HMRC on 8 April 2019. BEIS has engaged with HMRC since the original ruling to develop an evidence base on the typical ratio of materials costs to total installation costs of ‘solar PV’ and ‘solar PV plus storage’ packages.
2. Did the Government account for the potential VAT rise in the decision to end the Feed in Tariff (FIT) and export tariff?

In 2015, we announced that the generation tariff would close in 2019. We decided to close the export tariff alongside the generation tariff because we did not believe that the FIT flat rate for exports aligned with the Government’s vision for fairer, cost reflective pricing, and our continued drive to minimise the costs to consumers.

The Impact Assessment that accompanied the closure of the FIT scheme presented a range of scenarios and did not attempt to produce a central deployment forecast. The rate of deployment of the various technologies is affected by a very broad range of external variables, such as technology costs, business models and global trade patterns; there can also be significant variations between regions, across different technology types, and for different capacity sizes. The potential impact of VAT could not be readily isolated in the Impact Assessment scenarios.

HMRC’s proposed amendments reflect the strong outcome the Government negotiated on behalf of industry and consumers - solar installations will be unaffected where material costs make up less than 60% of total installation costs or where they are provided to certain customers (further detail is provided below). We understand that most domestic solar PV installations will fall below the 60% threshold. As noted above, the previous proposal from the EC was to remove VAT relief on solar PV installations completely. For all energy saving materials including solar plus storage packages, the reduced rate will still apply where the installation is provided to:

- the over 60s;
- those receiving benefits;
- housing associations;
- certain other residential properties, including care homes, children’s homes and student accommodation.¹

Even where the 60% threshold is exceeded, the lower rate of VAT can still be claimed on the labour cost element of an installation. Finally, zero VAT is applied for installations to new builds.

3. What is your assessment of the net effect of these recent and proposed policy changes on solar and other small-scale renewables in the round, including the impact on the uptake and commercialisation of battery storage?

The impact of VAT changes, including on solar and combined solar-and-storage installations, was considered by HMRC as part of their consultation.

We have published impact assessments for both the closure of the FIT scheme and the introduction of the SEG. The latter notes that we could see higher deployment of small-scale low-carbon technologies under the SEG compared to a counterfactual where it had not been implemented, however we did not attempt to present a central forecast. This was because the export market is still developing and there is therefore a degree of uncertainty around potential tariff rates, and consequently levels of deployment.

¹ This covers: (a) a home or other institution providing residential accommodation for children, (b) a home or other institution providing residential accommodation with personal care for persons in need of personal care by reason of old age, disablement, past or present dependence on alcohol or drugs or past or present mental disorder, (c) a hospice, (d) residential accommodation for students or school pupils, (e) residential accommodation for members of any of the armed forces, (f) a monastery, nunnery or similar establishment, or (g) an institution which is the sole or main residence of at least 90 per cent. of its residents.
I would reiterate that solar installations should be largely unaffected by the proposed amendments, and solar-plus-storage installations benefit from a number of exemptions as set out above.

With regard to storage, HMRC clarified in 2017 that a single supply and installation of solar panels with battery storage in residential accommodation may attract a reduced VAT rate of 5% (with each case considered on the specific facts), where storage and solar are purchased from the same provider and installed at the same time. However, the higher VAT rate of 20% continued to apply in all other cases. Therefore, the changes announced in HMRC’s recent consultation in practice only impact upon the specific scenario where storage and solar are purchased from the same provider and installed at the same. Significant other segments of the market (e.g. retrospective addition of storage to rooftop solar PV) are unaffected by the change.

It is also worth noting that BEIS is taking steps to support the uptake and commercialisation of electricity storage systems, including batteries, in line with our ambitious plans for decarbonisation of the power sector. Our 2017 Smart Systems and Flexibility Plan and 2018 Progress Update on this plan set out a range of actions that we, Ofgem and industry will take to remove barriers to storage, ensure it can participate fairly in the market, and support innovation in the sector which will encourage uptake and commercialisation of battery storage. To date we have implemented over half of the actions set out in the Smart Systems and Flexibility Plan and we are committed to completing the remainder by 2022.

There may also be an impact on some heat pump and other low-carbon heat installations. Again, we have negotiated full continuation of relief where equipment costs are up to 60% of the total installation cost, as well as the continuation of the social policy exemptions noted above. We will work with the low-carbon heat industry to help it implement this change to VAT rules while continuing to maximise deployment.

4. What types of schemes are caught by the 60 per cent equipment cost threshold for access to reduced-rate VAT?

The changes will impact any installation of energy saving materials where the materials make up over 60% of the total cost of installation, unless the installation is to the customer groups outlined in Question 2. Where the cost of materials is more than 60% of the cost of installation, then the labour costs of installation will still be subject to the reduced rate.

HMRC's taxpayer impact and information note provides details of the impact of this change and notes that the majority of installations will be unaffected by the proposals.

5. How are the VAT proposals consistent with your Department’s decarbonisation priorities? What steps have you taken to engage with HMRC and the Treasury on this?

As outlined above, we understand most solar installations should be unaffected by these changes. As a matter of course, the Government keeps all taxes and reliefs under review. In line with the Government’s commitment to achieving net zero greenhouse gas emissions by 2050, BEIS and HMT are interested in exploring options for minimising the tax impact on green measures, but I would highlight HMT are responsible for setting tax policy.
6. When will small-scale generators who installed their technology after March 31st receive payment at a fair market rate for the clean power they provide to the grid for others to use? How will the Smart Export Guarantee pricing levels be set, will they be linked to wholesale prices, and if so, will there be a minimum floor price?

Subject to the will of Parliament, most electricity suppliers will have to begin offering SEG tariffs, to eligible small-scale low-carbon generators by 1 January 2020. Installations that have been installed before this date will be able to benefit from the SEG, provided they meet the eligibility requirements (which include, for example, not already receiving FIT export payments for the same exports).

It is important that we move from a consumer-funded subsidy model, and to allow for competitive cost-reflective and market-based solutions to come forward. The SEG obligation allows tariff rates and contract lengths to be determined by suppliers. There have also been signs of a nascent export market developing since the closure of the FIT scheme and, as set out in the Government response, the tariffs coming forward will be monitored, supported by an annual report by Ofgem. The Government will consider reviewing the tariff setting arrangements if it is considered that offerings are not reflective of market values or unreasonable discounts are being factored in.

7. The Government’s most recent estimates show that the monthly installation rate of solar was at its lowest in April 2019 since May 2010, what steps have BEIS taken to monitor the impacts of this on the industry?

In March 2019, a two-year high record number of installations made applications for the Feed-in Tariffs scheme before its announced closure. At the time, the SEG policy was still in development and had not been implemented.

The Government will continue to engage with stakeholders in the sector as the SEG develops and will actively monitor the development of this market, including the range of options available to small-scale exporters. The Government will ask Ofgem to report annually on the provisions made by suppliers for smaller scale exporters and will review this to monitor whether small-scale low-carbon generators are able to access the market and effectively sell exported electricity to the grid competitively. We will review the SEG tariff arrangements and potentially make legislative changes (following consultation) if we consider that competitive tariffs, reflective of market values, are not coming forward.

I hope these answers provide context and clarity; please do get in touch if you require any additional clarification.

CHRIS SKIDMORE MP