



Greening the tax system

How tax policy could support net-zero

March 2021

Tax and Regulation

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'Greening' the tax system - why now

With the commitment to a net-zero emissions target by 2050, the hosting of the COP26 climate conference later this year, and a commitment to 'build back better' after the Covid-19 crisis, the government faces a challenge to clarify how policy will get the UK on track to reach net-zero.

Business plays a crucial role in meeting the net-zero objectives and a significant number are already setting themselves highly ambitious climate targets, which in many cases are decades ahead of those set by the government. Yet it should not be underestimated that the transition to net-zero will require business to incur significant new costs as they invest in new low-carbon technologies and services. The Climate Change Committee (CCC) in 2019 put the annual investment cost at £50 billion between 2030 and 2050 to achieve the net-zero target¹, with most of the investment being delivered by the private sector.

In the current tough economic climate, it is crucial that business is provided with the right policy framework to support the delivery of net-zero. The scale of the climate challenge and delivery of the government's plans for a green industrial revolution call for innovative ways to use the tax system, along with regulatory signals, to scale up market opportunities in a carrot and stick fashion. All this must be done consistently with targeting opportunities for green growth in the UK. The build-up to COP26 and beyond offers a crucial moment for business and government to come together and get these plans in place. This is a once in a generation platform to boost climate progressive industries, associated skills, and innovation to show the UK can lead the world in the technologies of the future and accelerate our response to climate change².





Devising suitable regulatory frameworks will be key given the pressures on public finances. But fiscal measures, including environmental taxes and tax incentives, will also be an important lever in driving change. They can work to discourage damaging environmental behaviours (e.g., emissions taxation); incentivise investment in both the acquisition of, and research and development into environmentally friendly products (e.g., Vehicle Excise Duty, Research & Development (R&D) tax credit) and energy efficiency (e.g., capital allowances and reduced VAT rates).

This paper sets out some guiding principles which the CBI believes the government should consider to shape environmental tax policies for business over the coming decades. It then recommends a number of short-term actions government can take over the course of this Parliament to accelerate the business progress towards net-zero and some long-term priorities to support the government's 2050 strategy.

All parts of the economy need to transition to net-zero, and the tax system will play an important role in making this happen. This paper focuses on some of the largest emitting sectors: transport, buildings, the power generation, and industrial emissions, but the government should continue to shape tax and fiscal policy that supports decarbonisation in all sectors of the economy.

Tax policy fit for net-zero: guiding principles

'Greening' the tax system must go beyond simply looking at different environmental taxes, i.e., transport, pollution, and energy taxes, independently. It is crucial that the tax and regulatory systems are considered holistically and how each element drives the delivery of net-zero. In assessing how the UK tax system could be harnessed to improve its effectiveness in working towards net-zero, set out below are a number of guiding principles to be used in tax policy design and when reviewing the existing policies. These principles are:

- Polluter pays
- Certainty
- International co-operation
- Carrot and stick
- Greenhouse gas hierarchy
- Green technologies
- Transparency
- Circular economy
- Just transition

The above principles are explained below.

1. Polluter pays

Tax is a useful instrument to assist with the internalisation of externalities, i.e., the incorporation of the costs of environmental services and damages (and their repairs) into the prices of goods, services or activities which cause them. This directly contributes to the implementation of the 'polluter pays' principle and to the integration of economic and environmental policies.

In simple terms, green taxes should be targeted to a pollutant or a polluting behaviour (with clear definitions being provided as to what constitutes the pollution or polluting behaviour). They should be designed to introduce a price signal into the supply chain to promote alternative, less environmentally damaging behaviour by making alternative options more economically viable. The tax system should seek to penalise the polluting activities – both production and consumption – while using effective reliefs and subsidies to encourage activities that support the transition to a net-zero economy.

Furthermore, if there are viable low-carbon alternatives available, there is a case that taxes should be higher for the most polluting products and services as these are the priority to remove from the circulation. As green taxes will in many cases increase the price of environmentally damaging goods and services, this should translate into impacts on demand as well as supply and shift consumers towards greener alternatives. For example, large retailers have been required by law to charge for single-use plastic bags since 2015. The seven largest retailers in England issued around 86% (6.6 billion) fewer single-use plastic bags in the year April 2017 to April 2018 (1.0 billion) than they did in 2014 (7.6 billion). Though not a tax, with retailers instead expected but not required to donate proceeds to good causes, this policy measure has had a clear impact on consumer behaviour across the UK.

However, in implementing the 'polluter pays' principle it is crucial that the tax mechanisms are targeted at those points in the value chain where they will influence the decision makers who have the ability to make investment decisions which will result in lower carbon emissions. For example, tax breaks for zero emission vehicles work because consumers have the option to buy them. In contrast, tax breaks for hydrogen fuel cell trucks may not be as effective in the short-term because hydrogen is not currently routinely available. In this case tax incentives would be more appropriate further up the value chain with potential hydrogen producers. Given these sector and technology-specific implications, it is vital that decisions on the use of tax measures are based on the latest data and evidence to ensure that desired impacts are being delivered.

2. Certainty

The CBI report 'Goal 13 Impact Platform: emerging findings' found that the most frequently cited external barrier which is stopping or slowing down business to progress their climate objectives is an uncertain policy and regulatory environment. To address this, the government must provide long-term certainty to underpin the investment decisions by consumers and businesses. Long-term certainty of taxation allows businesses to commit to long term investment if budgets underpinning this strategy have a reduced risk of surprise costs. For example, for manufacturers it takes time to ramp up their production, so they need certainty that there will be a strong UK market at the point when their products are released into the market. For tax policy, any tax incentives must be broad and available for the whole duration of the project life cycle. Like regulation, tax charges and tax incentives need to have a long term outlook that accounts for product life-cycles and technology developments.

Planning for any tax incentives should also take into consideration the current proposals by the OECD around the Tax Challenges Arising from Digitalisation, Pillar 2. Based on these proposals, tax incentives can lead to a lower effective tax rates for corporates. The tax consequently would need to be topped up in the country of the ultimate parent (IIR). This is an important consideration when designing any green tax incentives, as there is a risk that they may be rendered ineffective.

3. International co-operation

Climate change is a global threat that will irreversibly affect all regions of the world. However, the reality is that taken collectively, current nationally determined contributions are not enough to avert the looming effects of climate change³. Fragmented domestic policies will not achieve a sound transition towards a global resource-efficient, net-zero carbon and circular economy. Businesses involved in multiple markets, such as global value chains, cannot afford to be exposed to widely differing tax and regulatory systems. Strengthening international co-operation across environmental policies, including green taxation, is therefore necessary.

In the run up to COP26, the CBI urges government to not only accelerate progress towards its own net-zero objectives but also fully utilise its leadership role in imploring other countries to bring forward their plans to cut emissions and set net-zero targets. For example, collaboration on carbon pricing, such as through linking emissions trading systems (and their tax treatment) and shared approaches to carbon pricing should be sought (both in terms of the base to be taxed and the rate of taxation). More international co-operation is also urgently required across sectors such as aviation, shipping, and finance.

For business, it is crucial that UK environmental tax policies are co-ordinated or at the very least considered in the international context to avoid excessive administrative burdens, unintended consequences, and damaging effects on the UK's competitiveness. For example, co-operation with the EU is important to ensure the most efficient use of existing and future regional decarbonising infrastructure. An unbalanced environmental tax policy risks production moving out of the UK or overseas manufacturers having a competitive advantage.

4. Carrot and stick approach

In line with the 'polluter pays' principle above, the government should tax a 'bad' such as pollution but also reward a 'good' such as a reduction in pollution. However, it is important to consider how these measures interact: if you tax a 'bad' too much, it potentially constrains the ability to do the 'good'. The use of carrots and sticks by the government should be balanced to encourage action from consumers and businesses. For consumers, the focus should initially be on incentives, given the need to grow demand during the post-pandemic recovery period, with sticks more useful in the future. The judgement about when to apply taxes to business should also recognise the need to accelerate investment in the recovery period, but need not wait as long as for consumers, as arguably businesses are better equipped to plan ahead.

The overall carrot and stick approach should be set out in a clear roadmap of how these taxes will develop over time to provide business and consumers with certainty and enable them to adapt. This should be achieved by developing and publishing a strategic tax roadmap for the UK's post-pandemic tax system with the net-zero objectives placed at the core of the tax strategy.

5. Greenhouse gas hierarchy

The government's policy frameworks, including taxation, must focus on incentivising carbon reduction ahead of carbon offsetting. Offsetting allows business and consumers to continue with a carbon producing behaviour in a way that will potentially slow a step change in a sustainable reduction of the carbon emissions. It is important that the rules for offsetting are clear and robust and the price signals for carbon credits are set over the longer term.

Energy and carbon reduction tax policies should focus on the elimination of carbon emissions and be designed with a greenhouse gas (GHG) management hierarchy approach, developed by the Institute for Environmental Management and Assessment (IEMA)⁴, in mind. The tax policies should encourage business to take the following action in respect of GHG emissions:

- **Eliminate** (by using green design, recycled materials, regenerating existing stock, e.g., retrofitting rather than demolishing and re-building in construction).
- **Reduce** (through innovation/investments in efficiencies, e.g., reviewing energy usage, water consumption, waste production, reducing business travel etc.).
- **Substitute** (moving from fossil fuels to renewables).
- **Compensate** (purchasing appropriate number of carbon credits, carbon capture and storage solutions, self-created forestry offsets etc.).

6. Investment in green technologies

The investment levels required to reach net-zero means that taxation must be used as a tool alongside the right policy and regulatory frameworks to support investment and innovation in a range of low-carbon technologies. The 2020s and 2030s need to deliver significant scale-up and deployment of technologies like carbon capture, electrification of transport and heating, hydrogen production and its use across a range of sectors. Tax incentives need to support the investment into deliverable green R&D.

Furthermore, as the UK accounts for less than 1% of annual global emissions⁵, significant progress needs to be made internationally. The UK should play an important role in helping other nations reduce their emissions in line with the Paris Agreement. This leadership should be based on a strong investment in green technologies, which in turn creates business opportunities for the UK to export clean technology ('cleantech'), skills, services, and products. Supported by the UK's leading role in the development of green and sustainable finance, shaping new trade agreements and facilitations post-Brexit, and diplomatic leadership at events like the G7 and COP26 the UK can help accelerate progress at home and abroad.

7. Transparency

Complete transparency around environmental taxes is needed. Business is concerned that there has been a shift from green taxation that is tackling climate change to it becoming just another revenue raising mechanism. Effective environmental taxes should be designed to raise less revenue over time, i.e., if the green taxes are designed with proper principles in mind, the ideal outcome is that they raise nothing. Environmental taxation should promote the transition to net-zero and as a transitional tax, its main objective should not be as a revenue raiser.

It is important that any tax system changes are carefully considered against the government's net-zero objectives. The policy objectives should be transparent and clear; any proposals for new environmental taxes should follow an established policy making process with stakeholders properly consulted in a timely and transparent way. In addition, common approaches should be taken (e.g., with Financial Reporting Council and other Environmental, Social, and Governance transparency reforms) to ensure consumers have relevant information to enable them to make appropriate and consistent decisions (e.g., common indices).

Like transparency, good communication is essential for a successful environmental tax policy. Well-communicated tax policy choices that look at long-run benefits in terms of people's well-being, environmental protection, and resilience to climate and future shocks can increase public acceptance⁶. This applies similarly to green tax policies designed for business.

8. Circular economy

As set out in a World Economic Forum report⁷, over the past 200 years, economic and population growth migrated from previous circular practices for a move towards the current take-make-waste model, with 45% of emissions coming from how we make and use products and how we produce food.

It is important that when designing its environmental policies, the government considers the carbon produced over the lifecycle of a product – from extraction, through to manufacturing, use and then disposal (recycling). The aim is to reduce any built-in obsolescence in how some products are made. It is crucial that the government uses tax as a policy lever to support a transition to a circular economy, which in turn will help achieve the UK's net-zero objectives. The tax and regulatory environment must incentivise products that can be used for longer, especially where carbon inputs at the manufacturing stage/recycling are relatively high. Most importantly, the government's policies should encourage for the products to be repaired rather than replaced.

9. Just transition

The just transition must feature strongly in the government's climate strategies, including tax policy. The principle is rapidly gaining momentum in businesses' net-zero strategies. For example, energy companies across Europe are signing up to a just transition pledge and investors too are starting to integrate the just transition into their climate activities. Development finance institutions such as the European Bank for Reconstruction and Development and CDC are also coming forward with new initiatives.

It is important that tax policies are designed in a way that the costs of the net-zero transition do not fall unfairly on those least able to pay for them. This is vital not only for fairness but also to maintain public acceptance of the actions needed to achieve net-zero. Financing this investment will be a key challenge in achieving net-zero.



Short-term actions: net-zero quick wins

As a priority, the government should focus on three key areas that the CBI believes would have the most significant impact on acceleration towards the decarbonised economy: transport, buildings and industry.

1. Encourage a quicker uptake of zero emission vehicles

Transport continues to be the UK's largest carbon emitting sector. The emissions from passenger cars and light goods vehicles make up over two thirds of all transport emissions, so decarbonising those forms of transport is a priority. Whilst the government has expressed high ambition levels for phasing out diesel and petrol vehicles from 2030, this must be matched with support for consumers and business to adopt new vehicle technologies and for the delivery of infrastructure needed to make them viable alternatives. Below are some tax policy solutions that could help achieve a faster transition towards zero emission vehicles.

- **Company car tax (BiK):**

The 0% company car tax (BiK) rate for zero emission vehicles rises to 1% from April 2021 (BiK rate was down to 0% for 2020-21).

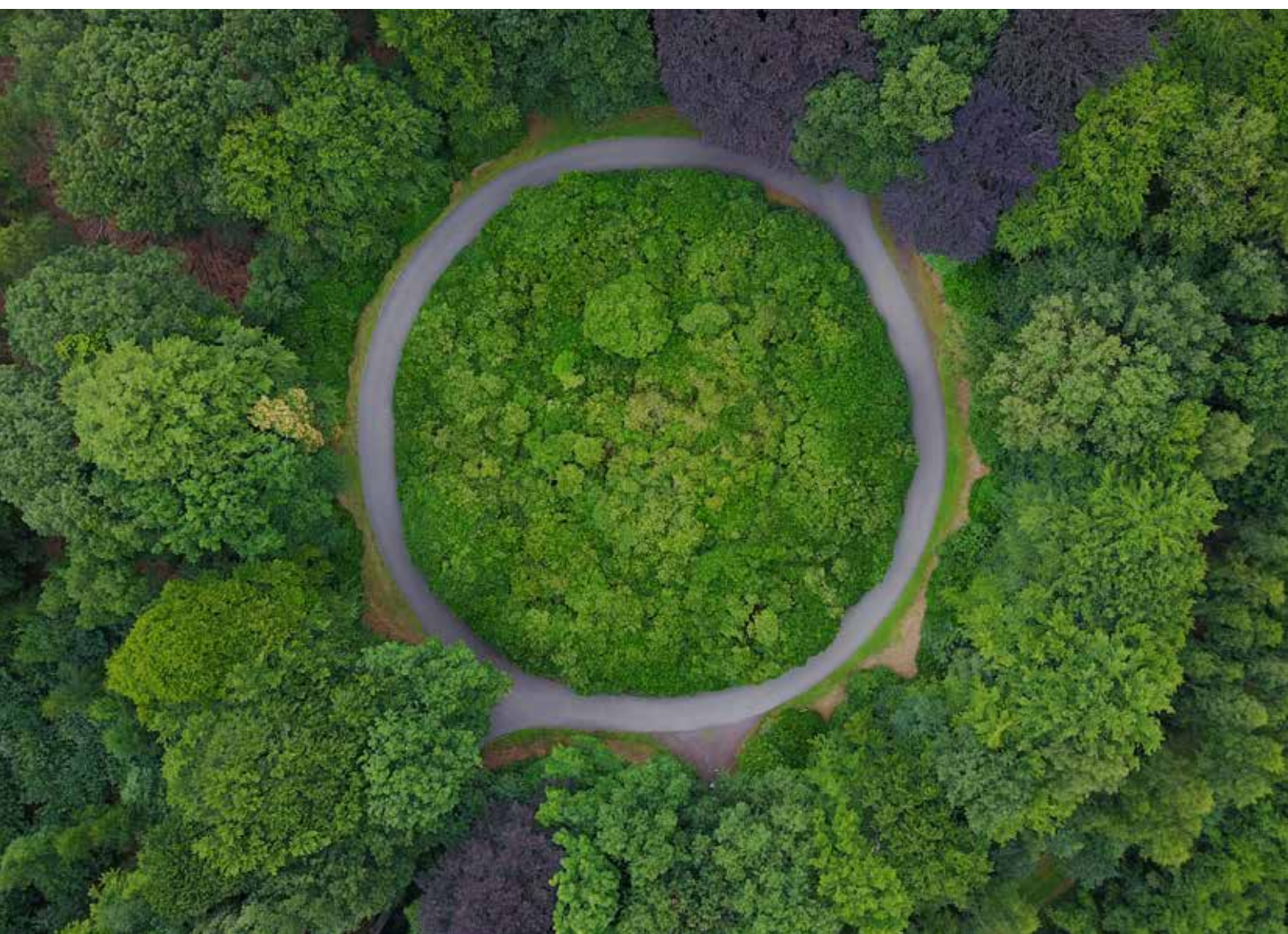
As stated above, one of the key principles the government must follow in developing tax policies is a long-term certainty of taxation. Although it is disappointing to see that the 0% BiK rate was not extended in Budget 2021, to lengthen the application of 1% company car tax (BiK) rate for zero emission vehicles could increase car fleets' changes as businesses gradually recover from Covid-19 and begin to make investment decisions again. This policy should be extended to cover employee loans for such vehicles. Furthermore, given the long-term nature of vehicle purchasing decisions, providing clarity on long term BiK rates would help with zero emission vehicles' uptake.

- **Capital allowances:**

Business welcomes the government's announcement in Budget 2021 that a 130% super-deduction tax incentives for two years will be introduced. However, more targeted, 'green' investment-focused capital allowances mechanisms for both incorporated and unincorporated businesses should also be maximised to drive the right behaviour. For businesses purchasing zero emission vehicles, or indeed making any 'green' capital investment, these capital allowances should be increased to 120% of the investment's value. The policy should also be extended to the zero emission vehicles leasing and rental sectors.

- **Vehicle Excise Duty (VED):**

Business welcomes the government's call for evidence on VED, supporting the need for it to be reformed to aid the transition to low emission road transport. However, simply increasing first year VED rates is not an effective response to solving the challenge of changing behaviours and purchasing decisions. Further consideration should be given on how costs can be spread over multiple years and the lifetime of vehicles.



- **VAT:**

VAT applies to the price of vehicles, their fuels and electricity. The government should conduct a review of the applicable VAT rates in respect of zero emission vehicles-related transactions with a view to bringing more consistency and simplification. The government should prioritise the following areas:

- Bring more consistency around the VAT treatment of electricity charging at home (reduced rate) vs. public (standard rate) electric vehicles charging points. Bringing the public charging VAT rates down to 5% to match domestic charging would support those without access to domestic charging.
- Reduce the VAT rate applicable to the sale of zero emission vehicles. There currently is no difference between buying an electric, hybrid or traditional fuel car when it comes to VAT. The government should particularly look to target sales at the cheaper end of the market, where price parity is moving more slowly (e.g., a small city electric car remains much more expensive than traditional fuel equivalents). The VAT incentive could be introduced alongside the current plug-in grant (PICG), or after the PICG comes to an end in 2023 to support delivery of the 2030 and 2035 target dates for ending the sales of new internal combustion engine cars and vans.
- Review the VAT rate on Personal Contract Hire (PCH) for zero emission vehicles. As an increasing number of zero emission vehicles are leased or acquired by PCH (which currently attract VAT on the monthly payments), reviewing this presents an important impact opportunity to encourage the uptake of the zero emission vehicles.
- Allow VAT recovery on company cars that are battery electric vehicles (BEVs) where they are in private use.



2. Support more energy efficiency, low carbon heat and use of renewables in buildings

Direct GHG emissions from buildings (mainly as a result of burning fossil fuels for heating) were around 17% of the UK total in 2019. Including indirect emissions (emissions from electricity use), buildings accounted for 23% of the UK total⁸. There is clearly a way to go to make residential, public, and commercial buildings more energy efficient and encourage switching to low-carbon heating. The government needs to ensure the tax system enables and not hinders these ambitions.

- **Business rates⁹:**

The tax environment determines many business decisions and, while the government can use certain taxes to incentivise positive business behaviours, such as encouraging investment in certain areas important for societal and environmental benefits, taxes can also be used to disincentivise negative behaviours. In some cases, taxes unintentionally create barriers and stifle what would otherwise be welcome activity. An example of this is business rates.

Business rates are often cited as a barrier to investment in non-domestic property improvements, such as investments aimed at increasing the energy efficiency of the property and reducing its carbon footprint. This is because a business rates bill is based on the rental value of a property, which increases as improvements are made. In addition, the calculation of a business rates bill also includes certain plant and machinery (P&M) items, so installing any of these items also comes with an associated business rates cost. The high burden of business rates (a tax rate of close to 50%) often means that the costs associated with improving the property outweigh the benefits and can make the investment commercially unviable. Green technologies such as solar panels are included in the business rates calculation, which can be the tipping point of that investment not going ahead. This means that too often these investments do not take place, which is out of kilter with the government's net-zero ambitions.

While reforming business rates is not the silver bullet, it has an important role to play in ensuring business rates are no longer a barrier to investment in property. Encouraging commercial property investments through a minimum 12-month exemption on any business rates increase associated with property improvements will help businesses to make viable investment cases, while regularly reviewing P&M regulations will ensure the system keeps pace with the need to modernise as new technologies are developed. Extending the original exemption for property improvements that result in an improvement in the building's Energy Performance Certificate (EPC) and exempting certain green P&M will incentivise businesses to make those green investments that reduce the carbon footprint of their buildings, helping to deliver sustainable economic growth and prosperity – including through increasing productivity.

- **Capital allowances:**

Existing systems in buildings are responsible for a significant element of GHG emissions. Businesses should be incentivised to upgrade their energy, waste management and pollution prevention systems. For example, if heat pumps are to be retrofitted to buildings that are currently using natural gas, higher capital allowances rates could be used to incentivise upgrading such systems. To qualify for the higher rates, the upgrade could be linked to the improvements in the EPC rating bands, for example, to A or B, or to any other measure of environmental performance that was considered appropriate.

Further, as of April 2020 the 100% First Year Allowance for energy saving products, the list of which was highly restrictive, was ended. This 100% allowance should be reinstated (and in line with the point made on vehicles above, potentially increased to 120%), with the qualifying criteria made much broader and principles-based, to encourage investment in a much wider range of beneficial technologies.

- **Structures and buildings allowance (SBA):**

Introducing a variable rate structure for SBAs could be used to incentivise a sustainable construction, renovation or conversion of buildings and structures. The government should also ensure that, where possible, SBAs are incentivising the retrofitting of existing buildings rather than demolition.

- **VAT on energy saving materials:**

The government has set a challenging target of reaching 600,000 heat pump installations per year by 2028¹⁰. A reform of the reduced rate VAT provisions for energy saving materials, including heat pumps, could help with incentivising the adoption of such materials.

Under the current rules it can be extremely difficult for the reduced rate to apply at all because measures are frequently implemented as part of a single supply of a heating system or do not conform with the very narrow list of allowed materials. The government should expand the permitted list and allow concrete and specific aspects of supplies to be carved out to allow the reduced rate to be applied to energy saving materials.

Furthermore, to facilitate the development of more sustainable and circular economy compatible products, goods produced using secondary materials, i.e. where the VAT has already been paid once, should be exempt from further VAT. This would promote the use of secondary materials and help address the situations where it is often less expensive to use virgin materials than recycled ones.

3. Motivate companies to innovate in industrial emissions reduction

Another sector critical for supporting the net-zero transition is the industrial sector. The sector has improved its emissions through a shift to lower-carbon fuels and improvements in energy intensity. However, deeper emissions cuts are required. The CCC has identified this as a key sector for government to support¹¹.

The government needs to deliver credible policy frameworks to encourage and enable economically viable further emissions reduction across this sector, whilst mitigating the risk of carbon leakage. In the immediate term, the forthcoming BEIS Industrial Decarbonisation Strategy must enable further emissions reduction across heavy-emission sectors, and a supportive tax policy environment needs to align to this strategy.

Innovation and the deployment of new technologies, such as fuel switching, more efficient industrial processes, and carbon capture and storage are at the core of enabling deeper emissions cuts by the industrial sector. The government must put in place policy rules that encourage businesses to make net-zero investments and support cost reduction in new technologies. The cost of these, instead of eventually being passed onto a consumer, could reduce the additional cost to consumers longer-term (for example, in packaging, any innovative solutions could result in businesses not being subject to a new plastic packaging tax and thus not needing to pass it on to end consumers).

Tax could play a crucial role in stimulating this innovation which in turn would result in reduced costs of alternative processes and products relative to carbon-intensive ones. The government should make it absolutely clear that R&D tax credit applies to innovative, sustainable, cleantech solutions. Expenses incurred in relation to the piloting and development of installations, e.g., in respect of the development of hydrogen power, carbon storage, clean heat etc., should qualify for the tax credit.

Furthermore, helping firms to research and develop, fund, and grow cleantech supports delivery of the government's 2050 commitment while strengthening the UK's economic recovery. With UK cleantech companies having attracted 73% more venture capital investment in 2019 than in 2018, almost doubling China's 37% rate of investment growth¹², it also provides an opportunity for the UK to become a world-leading destination for the development of cleantech.

Long-term vision: more certainty and a holistic approach needed

To harness tax as an effective policy lever in helping the UK achieve net-zero, business needs certainty in the long-term direction of travel, in particular around transport and emissions taxation. Most importantly a long-term tax policy framework is needed with the net-zero target at its core.

1. Review fuel duty

With the government's announcement to end the sale of new petrol and diesel vehicles by 2030, the need for a comprehensive review into fuel duty has never been greater. It is crucial that this transition is supported by a progressive tax system based on real world data to incentivise low emission driving, and more importantly, encourage the purchase of the right vehicles for the right journeys. The pandemic has highlighted the important role cars continue to play for mobility across the country and in particular those localities where access to wider travel options is limited. To meet emission reduction targets every effort must be taken to ensure each mile driven is a low emission one. Long-term fiscal policy can help incentivise this behavioural change.

To help achieve this, a complete review into the future of fuel duty must be conducted. As acknowledged by the Chancellor in the March 2020 Budget, the act of freezing fuel duty for the last 9 years has come at a cost to the taxpayer of £110 billion, and he noted both this fiscal impact as well as the environmental cost of this approach¹³. As a starting point, following the findings of the HM Treasury's 'Net Zero Review' due in spring 2021, the government should commit to launching a review into fuel duty in 2021. This should include providing clear signals of what will replace the current system over the medium-long term to support decarbonisation across transport modes - linking to the aims of the forthcoming Decarbonisation of Transport Plan, and how fuel duty will be applied to petrol and diesel vehicles, particularly where alternatives are less developed.

2. Provide certainty on the future of UK's emissions taxation

Business welcomes the introduction of the UK's Emissions Trading Scheme (UK ETS), however long-term certainty is needed on the approach to carbon taxation in the UK.

- **UK ETS:**

With the UK ETS having replaced the UK's participation in the EU ETS, as set out in the government's 'Energy White Paper'¹⁴, creating a new UK carbon market will be the foundation on which the UK achieves net-zero emissions cost-effectively. With the new UK ETS still in its early days, it is important that the government monitors the effectiveness of the regime, whilst working with stakeholders on a long-term plan to align the cap on the GHGs that businesses can emit with an appropriate net-zero trajectory.

Commencing the auctions of UK ETS should be prioritised to reduce the risk of unnecessary volatility and cost in the carbon and power markets, and ensuring an adequate supply of allowances. In the interests of greater liquidity and cost effectiveness, business also supports making progress towards linking with the EU's ETS, building on the commitments made in the UK-EU Free Trade Agreement on exploring this possibility.

Furthermore, with the government's plans to expand the UK ETS to two thirds of uncovered emissions, and future tightening of the UK ETS cap to ensure consistency with the CCC's 'The Sixth Carbon Budget' and path to net-zero, it is crucial that business is given enough warning to prepare and make plans for the future. The tax treatment of the UK ETS needs to be set out as soon as possible. The tax treatment of offsetting mechanisms for both providers and purchasers also needs to be clarified so that potential projects have a clear framework for investment decisions. Having early visibility of the trajectory of carbon pricing in the UK will allow businesses to plan and make long term investments in emission reduction projects with confidence. It is vital that any long-term plan is honoured, or it would have the opposite effect, undermining investor willingness to commit.

Also, as the UK embeds its own ETS, progress should be made towards linkage with the EU ETS. As this develops, consistency of UK Carbon Price Support signals, such as the confirmation of CPS rates for 2022/23 in Budget 2021, can provide certainty for business as the UK shapes a long-term approach to carbon pricing that is forward thinking and supports sector pathways to net-zero.

Finally, as the government develops its Industrial Decarbonisation Strategy, long-term considerations are needed on the future of carbon pricing in this sector. It is important to consider whether there is a more coherent and comprehensive way of enabling industry to decarbonise (similar to the energy sector), where there is a lesser need for compensation via free allocation. Such an outcome may not be possible in the short-medium term but may be able to be considered into the next few decades. Importantly, it would only be possible if there were cost-effective alternative processes and technologies available, and if markets are created for low-carbon industrial products to allow firms to pass-through costs to consumers in a way that avoids a loss of competitiveness.

- **Carbon Border Adjustment Mechanism:**

The reality is that countries are pursuing climate change objectives at a different pace and it is important that, when designing environmental tax policies, the UK government is mindful of the potential risks of carbon leakage – i.e., emissions increasing in foreign jurisdictions because of offshoring of activity driven by over-stringent domestic climate policies. Carbon border adjustments, which can take many different forms, are one option among others aimed at minimising carbon leakage. The EU is currently working on their carbon border adjustment mechanism.

The EU proposals for a carbon border adjustment mechanism tackle the problem of risk of carbon leakage and international competitiveness in a different way from the EU ETS. Instead of relieving high emitting industries, charges and levies would be applied and a carbon price of some form (tax or other) would be applied at the border to level up the carbon charges borne by imported goods. Carbon pricing is an international issue and, if the EU adopts a carbon border adjustment mechanism, there could be significant distortion of trade if the UK did not follow suit, e.g., diversion of cheap goods into the UK from low carbon price territories undermining the competitiveness of UK business.

The UK government will need to consider the potential impacts if the EU adopts a carbon border adjustment mechanism and any measures required to address those impacts. While many businesses acknowledge the benefits of carbon border adjustments in principle, the detail and implementation will be critical for ensuring these operate as intended to support investment in low-carbon products and processes.



- **Transition to sustainable aviation:**

According to the EU Aviation Safety Agency, the use of sustainable aviation fuel is currently minimal and is likely to remain limited in the short-term. However, there is a clear growth opportunity, and the UK has the industrial skills and capabilities to lead this developing sector.

The government's '10 Point Plan for a Green Industrial Revolution'¹⁵ was a positive step forwards in developing a market for sustainable aviation fuels, but business needs further targeted support for innovation (e.g., grants and loan guarantees), a long-term revenue support mechanism to enable growth in the market, and further support that develops a Sustainable Aviation Fuel clearing house. Given the international nature of the aviation industry, the government should work with its global counterparts through the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) to focus on supporting the ambitions the sector has on sustainable fuels (renewable fuels, green gas etc.), hydrogen, and electrification.

4. Set out holistic tax policy vision to achieve net-zero

It is crucial that the government determines the framework of both regulation and tax in this Parliament to signal to all actors how net-zero is to be achieved and its impact on them.

A growing number of firms are setting their own net-zero targets, which frequently are well ahead of those set by the governments. For example, more than 1,000 businesses worldwide are working with the Science Based Targets initiative (SBTi) to reduce their emissions in line with climate science. Long-term regulatory and tax policy certainty is crucial to facilitate the achievements of these science-based targets.

Clarity on the taxation and regulatory models that the government intends to deploy will be key to establishing certainty and confidence within the private sector. Climate change policy frameworks must not be at the whim of short-term political change - they need to support long-term confidence for investment and effective action. The Institute for Government sets out that the most sensitive area for the Treasury is tax policy, which needs to support and not undermine progress to net-zero¹⁶. The government needs to ensure that spending, tax, and regulation are all consistent with the net-zero goal. Its tax strategy must support the move to net-zero, showing taxpayers how and when taxes might change, and addressing such important issues as the substantial loss of revenue from fuel duty as the vehicle fleet is electrified. The roadmap should also reflect how increased remote working will affect the environment and environmental taxes (e.g., less public transport use, more energy consumption at home, reduced use of offices etc.).

The government should therefore publish a tax policy roadmap which places achieving net-zero by 2050 at its core. The roadmap should set out consistent and long-term environmental tax policy goals and a holistic vision of how tax contributes to support net-zero objectives. The roadmap should also be supported by a 'net-zero test' for all spending decisions from the Treasury and other government departments.



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About the CBI

Founded by Royal Charter in 1965, the CBI is a non-profit business organisation that speaks on behalf of 190,000 UK businesses of all sizes and from across all sectors, employing nearly 7 million people between them. That's about one third of the private workforce. This number is made up of both direct members and our trade association members. We do this because we are a confederation and both classes of membership are equally important to us.

The CBI's mission is to promote the conditions in which businesses of all sizes and sectors in the UK can compete and prosper for the benefit of all. With offices around the UK (including in Scotland, Wales and Northern Ireland) and representation in Brussels, Washington, Beijing and Delhi, the CBI communicates the British business voice around the world.

Our mandate comes from our members who have a direct say in what we do and how we do it

The CBI receives its formal mandate from 9 Regional Councils, 3 National Councils from Scotland, Wales and Northern Ireland plus 16 sector based Standing Committees. These bodies are made up of members in that region, nation or sector who serve a term of office. The chair of each Standing Committee and Regional and National Council sit on the CBI's Chairs' Committee which is ultimately responsible for setting and steering CBI policy positions.

Each quarter this formal engagement process across the CBI Council reaches over 1,000 senior business leaders across 700 of our members who have a direct say in what the CBI do and how they do it, from refreshing their workplan to discussing the key business issues of the day and re-calibrating its influence. Over 80% of the businesses represented on the CBI Council are outside of the FTSE350 as the CBI represents a wide range of sizes and sectors from the UK business community. This formal governance process is supported by a wide range of working groups, roundtables, member meeting and events that makes the CBI unparalleled at listening to and representing British business.

CBI Council in numbers



1000+

Committee and Council representatives



28+

Regional and National Council and sector based
Standing Committees



50%

Representatives of the CBI Council at C-Suite level



80%

Of the CBI Council from non-FTSE 350 businesses

To share your views on this topic or ask us a question, contact:



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