Carbon Reduction Commitment

Are you ready?

Illustration: Getty Images

Jane Jenkins, Andrew Thomson, Michael Reid and **Caryl Walter** of **Freshfields Bruckhaus Deringer LLP** examine the draft CRC Order and consider how businesses and the real estate industry in particular can respond.

Buildings account for almost half of the UK's total carbon emissions. Measuring, monitoring and, as far as possible, reducing the level of such emissions will become critical following the introduction of the Carbon Reduction Commitment (CRC) scheme, due on 1 April 2010. Yet many companies and landlords are unaware of the impact that the CRC scheme will have on their businesses.

This article considers:

- The draft CRC Order, which is currently being consulted on (CRC consultation), including how it will operate and how the real estate industry can respond (*see box "Useful links"*).
- The state of play on green leasing provisions.
- CRC-related issues for landlords and tenants.
- The role that tax can play in offering incentives to improve sustainable performance.

CRC SCHEME

So-called "cap and trade schemes" are fashionable internationally as a cost-ef-

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fective climate change policy tool. The EU's flagship regime, the EU Emissions Trading Scheme (EU ETS), is now approaching its third phase (*see feature article "EU emissions trading scheme: an overview", www.practicallaw.com/3-200-8253*). Both in Australia and the US, a change of administration has ushered in plans for large federal schemes.

While the UK is continuing to use more traditional command and control measures to reach its carbon reduction targets, it is now also introducing its own domestic cap and trade scheme under the Climate Change Act 2008: the CRC scheme (*see News brief "Climate Change Act 2008: implications for business", www.practicallaw.com/5-384-7908*).

The CRC scheme is projected to apply in full to 5,000 non-energy intensive businesses and public sector organisations. Although these businesses may not be inherently energy-intensive, they still emit about 10% of UK greenhouse gas (GHG) emissions. The government also estimates that around 20,000 organisations will have to participate in the CRC in some way, mainly by providing information about their energy use.

The CRC scheme will not apply to energy intensive installations whose emissions are covered by the EU ETS or organisations with more than 25% of their emissions covered by climate change agreements (*see box "CRC scheme in brief"*).

The draft CRC Order is currently undergoing its third public consultation, launched on 12 March 2009 (*see News brief "Carbon reduction: are you committed?", www.practicallaw.com/2-385-9969*).

The CRC scheme is scheduled to commence in April 2010, with participants qualifying on the basis of their electricity consumption in 2008. The Environment Agency, which is the administrator of the CRC scheme in England and Wales, intends to send out information to potential participants in May 2009, and qualification packs in September 2009. Whatever the results of the final consultation, the timeline for implementing any changes is tight (*see "Scheme phases" below and box "Practical steps"*).

Scheme phases

The CRC will operate by reference to phases, which will be divided into compliance years. Each compliance year will run from 1 April to 31 March the following year. The first phase will run from 1 April 2010 to 31 March 2013 (the introductory phase). The second phase will start on 1 April 2011 and the third phase on 1 April 2016.

Each phase has:

- A qualification period, during which organisations must decide whether they are covered by the CRC scheme based only on electricity consumption.
- A registration deadline by which qualifying organisations must register with the administrator as participant organisations in the CRC (*see "Participant organisations" below*).
- A footprint year during which participant organisations must calculate the total amount of their CO_2 emissions from various sources.
- A series of scheme years, which run from April to March. After the footprint year until the end of the phase, participant organisations must purchase allowances for each tonne of CO_2 they use (*see "Capping and trading" below*).

(*See "Compliance obligations" below and box "CRC timeline".*)

Participant organisations

The CRC scheme will apply in the first phase to public and private organisations whose annual electricity consumption from half-hourly meters (HHM) is in excess of 6,000 megawatt hours (MWh) in 2008. Once the threshold is triggered, all energy use emissions are covered by the scheme, not just those from electricity use.

Much lobbying effort has focused on the threshold (which equates approximately to a £500,000 annual electricity bill). Some stakeholders have argued that it is too low and will place a disproportionate administrative burden on smaller organisations, while environmental groups have advocated an even lower threshold to catch a wider range of businesses.

The threshold is a variable which can be quite easily adjusted at the start of each phase of the scheme and could, in future, be used to impose more wide-ranging obligations.

The draft CRC Order proposes a "top-down" approach for group companies: compliance responsibilities are assigned to the highest UK parent organisation. Where there is a non-UK parent company, emissions from UK subsidiaries will be included in the scheme if they meet the threshold on an aggregate basis.

Since the subject of regulation is the legal person who is the customer of the energy supplier, and not physical entities, the draft CRC Order envisages certain de minimis thresholds. There is, however, still potential for multiple, medium-sized and diverse sites to be caught if their electricity consumption is attributable to the same legal person.

Landlord considerations. Landlords with a diverse portfolio of properties may be able to make use of the "90% rule" to reduce the administrative burden of having to measure and manage the carbon emissions of small premises. This rule allows an organisation to exclude up to 10% of the total emissions established in its footprint report (*see "Compliance obligations" below*).

However, an unintended consequence of this rule could be that, by electing not to count the small emitters, an organisation might be excluding precisely those least managed emitters with the greatest reduction potential. Whether organisations will tend to avoid dealing with such properties to minimise central administration costs, or strategically include them so that they can benefit from an

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improved league table ranking by implementing cost-effective reductions, remains to be seen (*see "League table and revenue recycling" below*).

In the case of tenanted properties, the party to the energy supply contract that is the regulated entity could be either the landlord or a tenant, although typically it would be the landlord. Initially, the government considered allowing some flexibility on the sharing of compliance obligations where both landlord and tenant qualified as CRC organisations. However, it is now of the view that transfer options would entail an unacceptable degree of administrative complication (*see "CRC-related issues" below*).

Ensuring that different tenants are treated fairly is a further consideration that landlords will need to address, and that tenants will be keen to discuss. Since large commercial landlords may own many diverse properties whose emissions will be aggregated for the purposes of the scheme, they may consider the possibility of running a "scheme within a scheme" to distribute costs and benefits in accordance with actual emissions. However, this will entail significant administration costs, with implications for the resourcing of service departments.

CRC scheme in brief

The Carbon Reduction Commitment (CRC) is a new compulsory emissions trading scheme for large non-energy intensive businesses and public sector organisations in the UK. It is being introduced (the expected date for implementation is April 1010) to help the UK meet its greenhouse gas reduction targets.

The CRC is a "cap and trade" scheme: the government either sells at a fixed price or auctions a limited number of allowances each year and participants can then either buy or sell those allowances from each other, depending on whether they have a deficit or surplus of allowances at the end of the relevant trading periods. An allowance represents the right to emit one tonne of carbon dioxide.

Participants in the scheme will also be incentivised by league tables that will be published ranking participants on their yearly performance and by the "recycling" of revenue derived from selling allowances, with high performers receiving proportionately more than those that perform less well.

The CRC will not apply to:

- Carbon dioxide emissions from energy intensive businesses, as these are already covered by the EU Emissions Trading Scheme.
- Organisations with more than 25% of their emissions from energy use covered by climate change agreements.
- Carbon dioxide emissions from transport.

Compliance obligations

In order to regulate carbon emissions, the CRC scheme requires that they are measured and monitored. CRC participants will therefore have a number of monitoring and reporting obligations at the different phases of the scheme (*see "Scheme phases" above*).

Qualification. Before the start of each phase, organisations that have at least one HHM settled on the half-hourly electricity market must determine whether they meet the qualification criteria for participation in the scheme. If they think they do not, they must make an information disclosure to the administrator.

Registration. Once an organisation has determined that it qualifies, it must register as a participant in the appropriate registration period and calculate the entirety of its eligible emissions "footprint" (currently proposed to be over a 12-month period). The emissions data must be submitted to the administrator in a footprint report, which also contains information about organisational energy use and sources.

Annual requirements. CRC participants will also be required to submit an annual report at the end of each compliance year as the basis for justifying the quantity of allowances they intend to surrender (*see "Capping and trading" below*). The annual report will list only those emissions sources actually to be regulated under the CRC scheme (which will be a percentage of footprint emissions, since some of those may be left out under various exceptions).

Ongoing requirements. CRC participants must also maintain up-to-date records of documents relating to their energy use, to provide an audit trail by which the administrator can verify the data submitted in the footprint and annual reports.

CRC participants are encouraged to measure their energy use accurately. Energy consumption figures that rely on estimates rather than accurate documents or actual readings will be subject to an automatic 10% uplift. The CRC consultation acknowledges that it may not be possible for all participants to obtain completely accurate information, so the use of approximation data is inevitable in some circumstances. The government has indicated that it intends to provide guidance on suitable approximation techniques.

Capping and trading

CRC participants will not simply be given an absolute regulatory constraint: they will be encouraged to become actors in a market in emissions allowances, each of which permits the holder to emit a tonne of CO_2.

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Practical steps

- Decide if the business will qualify for the Carbon Reduction Commitment (CRC) scheme and sign up to the CRC mailing list (*www.defra.gov.uk/carbonreduction*) (*see also box "Useful links"*).
- Ensure the qualification pack (due in September 2009) is completed. Decide if registration as a full participant is required.
- If the business does not meet the qualification criteria, make an information disclosure to the administrator.
- Prepare for the first sale of allowances in 2011; for example, consider how many allowances may be needed based on current emissions.
- Ensure that the business will be in a strong position on the league table to benefit from revenue recycling. In the first year, this could mean installing automatic meters and attaining the Carbon Trust Standard.
- Landlords and tenants need to consider the impact of the CRC scheme in lease negotiations. Landlords cannot pass on their CRC obligations to their tenants.
- Landlords and occupiers should bear in mind the availability of capital allowances when considering the installation of energy-saving equipment.

The allowances will be allocated as follows:

- Initial sale of allowances. During the introductory phase, there will be an annual fixed price sale of allowances at £12 per tonne of CO_2 with an unlimited supply (*see "Scheme phases" above and box "CRC timeline"*). This phase is designed to give participants the opportunity to gain experience in forecasting their expected allowance requirements and other aspects of the scheme, and to allow the administrator to collect accurate emissions data.
- Capped allowances. From the second phase onwards, the overall number of allowances available in each phase will be capped, and the allowances auctioned to CRC participants. Distinct phases are designed to allow for the entry and exit of participants as they meet or fall outside the qualification threshold, and allow the government to restrict the quantity of allowances taking into account data collected in footprint years.

Other key features include:

- Compliance years. Emissions allowances must be bought and surrendered for each compliance year, which runs from April to March. After the initial introductory phase, allowances will be capable of being "banked" and remain valid over any number of compliance years and phases.
- Freely tradable allowances. Once the initial allocation has transferred allowances to CRC participants, participants are free to buy and sell to each other. In the EU ETS, an unregulated secondary market has led to derivative instruments and specialised brokers. The CRC, too, is proposed to be freely accessible so that the scheme may reap liquidity benefits: any organisation may open an allowance account to hold and trade allowances, and no absolute limit is proposed on the amount that any one organisation can hold. The government has said that a "notice board facility" to facilitate trading is planned; however, it notes that it expects third parties to implement external trading platforms as well.
- A price corridor. The price of allowances will move only between certain parameters. The auction floor price is proposed to be £12. If the price of CRC allowances at any time rises above the prevalent price in the EU ETS, a "safety valve" mechanism will allow participants to purchase additional permits from that scheme.

Most importantly, perhaps, the CRC is not like any other market in that the sums paid for allowances will be handed back by the government: the market mechanism is employed as a regulatory tool only to maximise efficiency, not for revenue (*see below*).

League table and revenue recycling

An important feature of the CRC scheme is a public "league table" which will rank participants according to their performance in each year. It has the dual purpose of providing financial and reputational incentives. While all the revenue from the sale or auction of allowances will go back to participants, it will be apportioned according to their published rank in the league table.

A bonus or penalty payment will be assigned to each league table position. Initially, this will be +/- 10% of the purchase price of an organisation's allowances, but the bonus/penalty set will be successively scaled-up to reach +/- 50% in 2015. (According to government estimates, the maximum net financial incentive that this range could provide would be a +/- 1.5% change in an organisation's energy bill in 2010, increasing to +/- 8% in 2015.)

The ranking will be composed of three "metrics":

- The absolute emissions reduction metric.
- The early action metric. This comprises: the percentage of an organisation's emissions certified by the Car-

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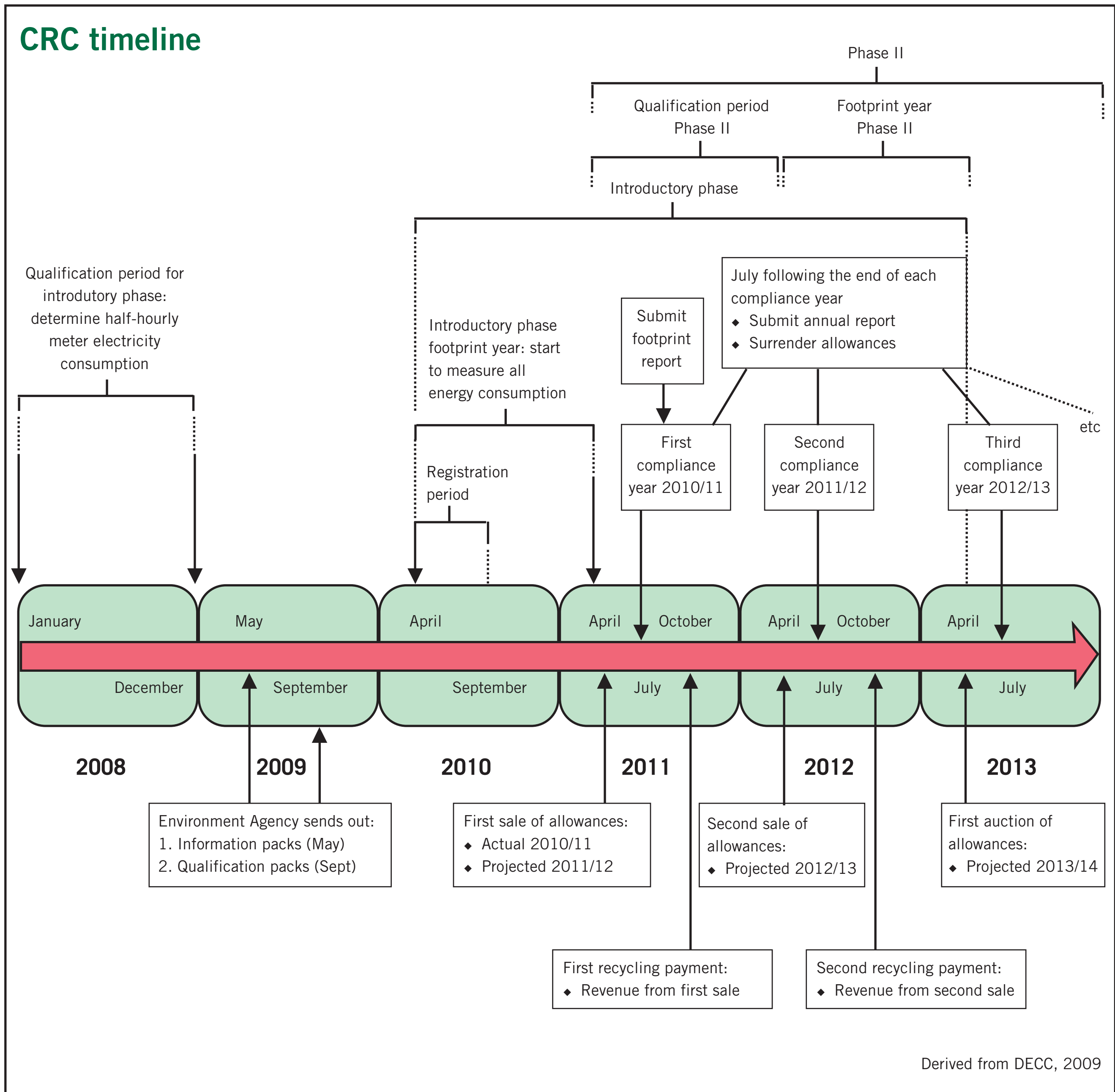

bon Trust Standard (CTS), which requires both measurement and a commitment to reduce emissions; and the extent to which an organisation has opted for voluntary early installation of automatic metering (beyond the legal minimum).

- The relative carbon efficacy metric, measuring change in emissions relative to turnover (the growth metric).

All three will be combined on a weighted average to calculate an overall performance score. In the first year, only early action data will be available, but during the rest of the first phase the weighting will be 60:20:20. In subsequent phases, the weighting will be 75:25, with the early action metric dropping out of the equation.

The league table has been criticised by the commercial property sector for failing to differentiate between sectors with different abatement potential (that is, emissions reduction potential), so creating a bias in favour of those types of CRC participants that are fundamentally better able to manage their emissions. Commercial property landlords, it has been argued, can carry out only a limited amount of cost-effective reduction compared to other participants, even where they are able to secure the full co-operation of their tenants.

The government has responded that it would not be practically feasible both to retain the organisation-level point of regulation and also split organisations into meaningful peer groups. It therefore appears unlikely that this aspect of the CRC will be different in the final version.

Auditing and penalties

The light touch approach proposed for reporting and auditing requirements (*see "Compliance obligations" above*) means that there are likely to be strong penalties to encourage compliance. The CRC consultation envisages a mixture of civil and criminal penalties for offenders. However, the CRC scheme will rely mostly on civil penalties, comprised

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of fixed fines, variables fines, publication of non-compliance and blocking the trading accounts of participants.

The key penalties are:

- Failure to register by the required date: a £5,000 fine, subject to increase at a daily rate of £500 for each working day until registration takes place or the next reporting deadline is reached. If, by that point, the organisation still has not registered, it will be subject to the reporting penalty (*see below*). (Organisations with HHM that fell below the 6,000 MWh threshold in 2008 and are therefore only required to make an information disclosure, are subject to a fixed fine of £1,000 for failing to do so).

- Failure to provide a footprint or annual report: a fixed £5,000 fine. Further cumulative penalties apply per unreported tonne of CO_2, with another deadline after 40 days, after which stronger financial penalties kick in. In addition, failure to provide an annual report will lead to an automatic bottom ranking on the league table. The provision of inaccurate information to the administrator in a footprint or annual report will incur a penalty of £40 per unreported tonne of CO_2, as will failure to comply with the performance commitment to hold and cancel sufficient allowances to cover an organisation's emissions at the end of the compliance year.

- Failure to keep adequate records: a £5 fine per tonne of total emissions recorded in the CRC participant's most recent report.

- Knowingly or recklessly providing false or misleading statements or evidence, or the failure to co-operate with the administrators: criminal penalties may be imposed. Where an offence has been committed with the consent, connivance or negligence of an officer of the organisation, both the officer and the organisation are guilty of the offence. On indictment, falsification offences are punishable by up to three years' imprisonment (for guilty officers) and/or a fine of up to £50,000; non-compliance with enforcement is punishable by up to two years' imprisonment and/or an undetermined financial penalty.

In each of the above circumstances, where a CRC participant is concerned, the administrator will also publish details of the failures on the CRC website. In addition, some of them will block the participant's allowance account, preventing it from trading.

Each year, the administrator will audit a proportion (the current proposal being 20%) of CRC organisations to ensure their compliance. Audits will include a desk-based assessment and any site visits that the administrator considers necessary. Organisations will initially be selected for audit on the basis of their risk of non-compliance, but all organisations are expected to be audited at some point during the scheme.

Industry concerns

The industry response to the new regime has been mixed. The British Property Federation (BPF) and individual large players in the commercial property sector have raised a number of issues during the consultation process, including the following:

Property portfolios and sales. Many property portfolios are in flux, that is, continuously traded, including between organisations that will fall within and outside the CRC scheme. The draft CRC Order is ill-equipped to deal with this because organisations' footprint baselines are set for the entirety of each phase.

It is therefore unclear how property owners will address the CRC scheme in sale and purchase transactions; for example, what should happen if a seller who is within the scheme sells to a buyer who is not? Certainly a buyer will want information on the seller's status under the CRC and on whether the building has been included within the scheme. If the building has previously been included, the sale documents will need to deal with how the seller and the buyer will treat the building in the context of the CRC scheme. At this stage, it is difficult to anticipate how this might work but, as with the landlord and tenant relationship, it is going to need the parties to work together to achieve a workable solution.

Impact of aggregation. The aggregation of all CRC-regulated sectors in the league table could mean that large landlords will be institutionally disadvantaged compared, for example, to manufacturers and effectively forced to subsidise them through penalty payments.

Costs for landlords. The largest commercial landlords, with the biggest energy bills and therefore the biggest historical incentive to manage their energy use, will be the ones footing the bill for small, more energy-intensive participants with more current abatement potential.

The BPF has suggested (and the government is officially encouraging) the development of good practice guidelines for voluntary costs sharing agreements and, in particular, the idea of energy efficiency investment funds. These would be funds financed primarily by tenants with a view to reducing their collective running costs, and run jointly by tenants and landlords, which have an incentive both to improve their league table position and to increase the value of their property.

GREEN LEASES

For a time, it looked as though green leases (that is, leases that seek to address the energy and environmental impact of a building or portfolio of buildings) would move close to the top of the agenda for landlords and occupiers, with some major occupiers marking environmental considerations as high as second on their lists of key criteria when taking on new space.

However, with the economic climate taking a turn for the worse, we have seen only limited examples of landlords letting buildings on green terms. These have tended to concentrate on informa-

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Landlord and tenant concerns

Landlord	Tenant
• Obtaining information on the tenant's expected energy consumption and any likely changes to its plans, so that the landlord can budget for allowances. If possible, the tenant would agree not to exceed its estimates. • Obtaining a contribution from tenants to the administrative costs of the Carbon Reduction Commitment (CRC) scheme, perhaps via the service charge. • Recovering a fair proportion of the cost of CRC allowances from tenants and recovering the costs of having to buy further allowances and/or reimburse the landlord for its lost CRC "bonus" if a tenant exceeds its estimated energy use. • The possibility of the tenant becoming the counterparty to the energy supply contract, although this will have disadvantages more generally. • If terms are included that are potentially onerous on the tenant (they will be non-standard for quite some time as this is a new area), a tenant may seek a discount at review. A landlord could seek to have CRC terms disregarded, but will have difficulty in making a tenant accept this.	• Receiving notice in advance of a landlord becoming a CRC organisation (if it is not already). • Receiving a share of any CRC bonus achieved by the landlord for the building (to the extent that the tenant's reduced energy consumption is responsible for that bonus). • Taking no responsibility for the landlord's failure to comply with administrative duties or missing out on CRC bonuses as a result of the actions of the landlord or other tenants.

tion sharing and general co-operation, such as the landlord and tenant agreeing to produce an energy management plan for the building and then operate the building under it.

Landlords have also been protecting themselves against tenants invalidating energy and performance certificates (EPCs) or display energy certificates (DECs) for their buildings by putting restrictions on tenants obtaining these themselves.

The reason for the so far limited take-up is relatively obvious: discussions over green clauses in leases are essentially commercial discussions, because any clause with "teeth" will cost one or both parties money, if only in the short-term. For example, an amendment to the service charge schedule to allow the landlord to provide energy from sustainable resources may cost the tenant money, even if there are wider benefits. Equally, requiring a tenant only to use sustainable materials in a fit-out will cost it money.

With the leasing market moving very much in favour of tenants over the last year or so, landlords are not able simply to force green clauses on tenants and, as landlords are also feeling the economic pressure, they are understandably unwilling to push the point as lettings are too precious to lose for lack of green terms.

However, with the real cost of the introduction of the CRC looming large on the horizon, landlords and occupiers will be paying more attention to green issues over the coming months, so they may slowly progress back towards the top of the agenda (*see "CRC-related issues" below*).

Office occupiers are already becoming more open to the benefits of sustainable buildings and processes; however, retail tenants are still reluctant to consider anything that may increase cost. In both areas, for shorter-term arrangements or small spaces, tenants are still keen to secure a fixed cost for their occupation, which does not fit easily with a green lease.

CRC-RELATED ISSUES

The government's decision in the draft CRC Order to drop the ability for the landlord to transfer its CRC obligations to the tenant is problematic.

As a result, there are a number of key concerns for landlords and tenants during lease negotiations (*see box "Landlord and tenant concerns"*).

These issues are very much in their infancy and will develop as the results of the CRC consultation come out, but it is a difficult area that landlords and occupiers cannot simply assume will resolve itself in practice.

There is also much uncertainty about how sustainability will be valued, as there is no general consensus on the criteria to be used. This is true both from a capital value and a rent review point of view. The expectation is that, in the short- to medium-term, sustainable buildings will become more attractive to owners and occupiers, which should drive up value; the difficulty will be in

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Useful links

Consultation on the Draft Order to Implement the Carbon Reduction Commitment	www.practicallaw.com/3-385-3349
Draft Carbon Reduction Commitment Order 2010	www.practicallaw.com/5-385-3334
Summary of draft Carbon Reduction Commitment Order 2010	www.practicallaw.com/0-385-3336
Carbon Reduction Commitment User Guide	www.practicallaw.com/1-385-3345
Carbon Reduction Commitment - How will I comply?	www.practicallaw.com/9-385-3346

quantifying this. How the introduction of the CRC will affect this area remains to be seen: at the very least, it ought to accelerate the process of sustainability being factored into valuations.

Achieving fairness for landlords and tenants in the context of the CRC generally and, in particular, in the landlord and tenant relationship, will be a real challenge. As it currently stands, no one can be sure that the mantra of "polluter pays" will remain true in this area or that the CRC will place increasing pressure on the management of green issues between landlords and tenants.

TAX CONSIDERATIONS

Tax incentives and disincentives can also play a part in reducing GHG emissions from commercial buildings. In particular, they can be used to:

- Encourage energy-efficient fit-out of buildings (through better design, more efficient equipment or microgeneration (electricity produced by households and businesses onsite using small-scale renewable energy technologies)).

- Influence occupier behaviour to minimise energy consumption.

Current position

The current system of incentives and disincentives largely dates from 2001, which saw the introduction of:

The climate change levy (CCL). The CCL is a tax levied on energy supplied other than for domestic or charity use (*see News brief "The climate change levy: budgeting for bad weather", www.practicallaw.com/9-101-1507*). It is paid by suppliers but reflected in the price occupiers pay for the energy they use. The level at which it is set means that it has a relatively small influence on the price of energy. There are reliefs for electricity generated from renewable sources.

Neither these reliefs (which do not cover nuclear power) nor the rates at which the CCL is charged on different sources of energy (set by reference to energy content, not emissions) are particularly well aimed at reducing GHG emissions. There is, however, a draft EU proposal (not yet published) to reform energy taxation to include an emission-related element from 2013.

Enhanced capital allowances (ECAs). ECAs provide 100% first-year allowances for specified products or categories of product; for example, energy-efficient lighting equipment. However, these are aimed at equipment that uses energy more efficiently: the source of the energy (and its GHG emissions) is irrelevant. Some of the exclusions seem arbitrary: roof insulation, for example, is not included. Also, since ECAs incentivise expenditure on products and systems which can be put in buildings, design techniques to maximise natural light and ventilation are not covered.

Awareness of ECAs has historically been low and take-up lower, although there are now signs of improvement. One reason for this is that the list of qualifying equipment is revised annually: equipment is sometimes removed from the list between the decision to acquire it and the acquisition itself. (The process continued in the 2009 Budget, which announced the removal of three sub-technologies alongside the inclusion of one new technology and two new sub-technologies.) Another is that the complexity of the requirements for making claims discourages taxpayers from using the scheme.

The introduction of the annual investment allowance (AIA) in 2008 has further complicated the picture (*www.practicallaw.com/5-380-9416*). Where a group's qualifying expenditure is within the AIA (currently £50,000), it is simpler to claim the AIA than ECAs. On the one hand, this means that it is now easier to claim tax relief for energy-saving equipment than it was; on the other, the AIA does not incentivise expenditure on energy-saving equipment (or, more accurately, the energy-saving equipment which meets the ECA criteria) over expenditure on other equipment.

The introduction of payable ECA credits from 1 April 2008 extended the benefits of ECAs to loss-making companies, filling one gap in the scheme (*www.practicallaw.com/5-380-9416*). However, entities such as charities and pension funds, which are exempt from income tax and corporation tax, are still not able to benefit from ECAs.

Even where ECAs are not available, the availability of ordinary capital allowances may influence decisions on energy-efficient fit-out.

What could be done

Possible tax incentives to encourage sustainability include:

- Improving the capital allowances regime to fix the flaws mentioned above.

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- Stamp duty land tax (SDLT) reliefs.

- Reduced VAT rates.

- Changes to the system of business rates.

SDLT. SDLT has several features which could affect its use in incentivising lower GHG emissions:

- SDLT is levied on transactions, rather than being linked to expenditure on fit-out, so the greening of the building would not necessarily lead to immediate relief; but this may not be a problem since, if a property would be relieved from SDLT on a future sale, its balance sheet value should increase (giving rise to a benefit to the owner separate from the cost to the exchequer).

- As with capital allowances, SDLT reliefs would focus on construction and/or fit-out, not behaviour, but they could take into account the performance of a building as a whole, rather than items of equipment out of context.

VAT. VAT on inputs is not a significant cost to most occupiers of commercial buildings or to the vast majority of landlords. It is therefore difficult to see reduced rates of VAT making a significant contribution here (although reduced rates of VAT are of value to charities, unlike most other tax incentives; and of course such measures may be valuable outside the commercial property sector).

Business rates. These have advantages as a means for encouraging energy efficiency in commercial buildings:

- They are an ongoing regular cost, paid by occupiers, so can be used to influence the behaviour of the users of the building.

- They are a significant cost, so can give rise to significant incentives: rates in England for 2009-2010 are generally found by applying a multiplier of 48.5% to the market rent as at 1 April 2003 (as determined by the Valuation Office Agency).

Related information

Links from www.practicallaw.com and the web

This article is at www.practicallaw.com/8-386-0583

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At present, however, business rates serve as a disincentive to energy-efficient fit-out: any expenditure on a property to improve its energy-efficiency is likely to increase its rental value and therefore its rateable value. It was only in 2008 that the legislation applying in England was amended to prevent the installation of microgeneration equipment from giving rise to an immediate increase in rateable value (rather than at the next five-yearly nationwide revaluation) (*Valuation for Rating (Plant and Machinery) (England) (Amendment) Regulations 2008 (SI 2008/2332)*). Removal of this disincentive effect would be an obvious place to start.

There have been more radical proposals that business rates should be split into a system of bands, dependent on energy-efficiency or on improvements to energy-efficiency, without changing the total tax take. (These proposals have often focused on EPCs as the measure of energy efficiency, since they provide a benchmark already to hand; EPCs, however, only describe theoretical performance. DECs, at present not compulsory in commercial buildings, are a more credible benchmark, since they look at actual performance of the building in use; but even they may not be sufficiently sophisticated.)

The business rates system is, however, particularly complex at present: some businesses will soon be dealing simultaneously with increased rates, transitional relief and the consequences of deferring previous increases. Additional complication, however green, is likely to be a hard sell.

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