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'Not fit for purpose': Hydropower industry warns of 'chilling effect' of soaring business rates

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Image: The Rannoch dam hydro scheme | Credit: Ardtornish Hydro

EXCLUSIVE: Changes to business rate valuations have drastically increased costs for renewables developers and left many in fear that further hefty bills could be on the way

The British hydropower industry is being hamstrung by changes to business rates valuations which have lumbered some leading developers with crippling tax bills that have led directly to redundancies and curtailed plans to boost renewable energy capacity. Other developers, too, have been left fearful that future revaluation exercises could quickly make hydropower and other renewable technology projects uneconomic - a concern further exacerbated by the complex rules governing business rates relief across the UK.

The problem is particularly acute in Scotland and Wales where the vast majority of the UK's hydropower projects are located.

In Scotland, which is home to around 70 per cent of UK hydropower capacity, all projects apart from the largest pumped hydro stations were exempt from paying business rates, but in 2016 the exemption was removed, and then in 2017 assessors revalued rates for hydropower projects

According to the British Hydropower Association, as a result one developer saw the rateable value of their assets increase by 600 per cent overnight, while another saw their business rates bill increase from £40,000 to £160,000 a year.

"With hydro schemes you have no choice but to pay it off the bottom line," explained British Hydropower Association chief executive Simon Hamlyn. "You can't increase prices, you can't cut costs. Members were asking 'why should I bother carrying on generating?'

The Scottish government sought to tackle the problem by introducing a rate relief scheme that would bring rates on hydropower assets down to a level that is comparable with small wind and solar projects.

The relief scheme promised a 60 per cent discount on rates for all schemes up to £5m of rateable value. But the move was then undermined by the fact renewables-related rates relief is classified as State Aid, meaning there was a cap on the level of relief available that resulted in some larger developers with multiple hydropower assets still getting hit by huge tax bills.

One such developer is the Ardtornish Hydro on Scotland's west coast, which runs five small hydropower projects boasting 3.4MW of capacity.

Hugh Raven, managing director at the company, explained the initial business rates relief took its rates bill down to around six to seven per cent of turnover - "it was quite high, but reasonable," he said. But the classification of rates relief as State Aid meant businesses could only accrue benefits to a maximum of €200,000 of relief over a three year period.

Consequently, for the last financial year the Ardtornish Hydro's rates bill soared to £525,000. "We think it has made us the highest pro rata rates payer in Scotland and probably the UK," said Raven. "The rates were suddenly around 20 per cent of turnover. The consequence was that when one of our hydro loans came up we were unable to renew the loan. We ended up making a fifth of our workforce redundant."

Other developers are facing similarly hefty tax bills and according to both Raven and Hamlyn the problem is having a "chilling effect" on development, with developers reluctant to instal projects or upgrade existing assets to increase output given the risk the next round of business rates valuations in 2023 could increase bills still further.

However, a spokesperson for the Scottish government defended its handling of the rates valuation changes, insisting it had taken steps to provide relief to the hydropower industry. "Rateable Values are set by Assessors, who are independent of government," they said. "We are committed to delivering a net zero economy and are fully supportive of hydropower, which is why we have delivered the most generous non-domestic rates relief for hydro generators in the UK for a number of years - indeed, we have committed to providing a 60 per cent rates relief for the sector until at least 2032."

A similar situation is found in Wales where revaluations in 2017 drove up business rates for hydropower developers, with one company seeing its tax bill rise by 700 per cent. A grant scheme was introduced to help provide relief to developers whose schemes had suddenly become uneconomic. But the grant scheme was recently limited to the handful of community-owned projects in Wales, leaving the vast majority of developers once again facing crippling bills.

Industry insiders warn that the dampening impact of business rates on renewables development is not limited to hydropower, with other clean tech industries voicing similar fears that assessors' valuations of renewables assets are actively undermining efforts to increase the UK's clean power capacity.

"It hits hydropower, it hits solar," argued Raven. "It is hitting district heating projects - they get hit by rates revaluations as soon as they connect the first customer. The resulting tax revenues are financially immaterial to Treasuries but they are having a huge impact on whether or not distributed renewables projects are economic."

His comments were echoed by Frank Gordon, director of policy at the Association for Renewable Energy and Clean Technology (REA), who said the trade body was keen to see an overhaul of the current approach to business rates. "The current outdated Business Rates system has caused problems for many parts of the economy, and this includes on-site renewables and clean tech projects," he said. "REA would like to see a reformed Business Rates mechanism that actively incentivises businesses to install the equipment and technologies that will not only help reach net zero emissions, but also insulate them from current and future energy price volatility."

Reforms are planned in England, after the UK government recently announced plans to introduce a new business rates improvement relief package from 2023, so no business will face higher business rates bills as a result of qualifying improvements to a property they occupy for 12 months.

The Treasury maintains the reforms will enable businesses to make improvements to their premises that support the net zero transition, adding that the government will also introduce changes to encourage investment in green technology and support the decarbonisation of buildings, estimated to be worth around £170m over the next five years.

Moreover, eligible plant and machinery used in onsite renewable energy generation and storage, such as rooftop solar panels, wind turbines, and battery storage, is to be exempt from business rates from 1 April 2023 until 31 March 2035, while a 100 per cent relief for eligible low-carbon heat networks which have their own rates bill will also be available.

However, the reforms only apply in England and industry insiders maintain the changes should be both fast-tracked and extended to guarantee business rates exemptions for all green upgrades and remove VAT on clean technologies.

Meanwhile, the British Hydropower Industry is continuing to push for more effective rates relief in Scotland and Wales and hopes are high that legislation currently working its way through the British Parliament could provide a fix. Industry sources insist the Subsidy Control Bill could be used to clarify whether rates relief on renewable energy installations would qualify as a subsidy or not, providing a route to remove the cap on levels of relief for larger hydropower operators.

Raven hopes the legislation could "potentially resolve an egregious example of unintended consequences hammering renewables developer who have done the right thing and tried to deliver clean power capacity".

However, attempts to resolve the issue could be hamstrung by a stand-off between the governments in Holyrood and Westminster.

The spokesperson for the Scottish government insisted its hands were now tied when it came to offering more support for those larger operators now hit by the cap on the level of relief n receive under State Aid rules. "The Scottish Government went as far as it could by deliv hydro relief that is compliant with the new subsidy regime which was established by the EU-UK Trade and Cooperation Agreement, and not the Scottish Government," they said.

However, *BusinessGreen* understands that the Westminster government regards it as the Scottish government's responsibility to determine whether or not business rates relief should qualify as a subsidy, based on the definition that will be set out in the Subsidy Control Bill.

The definition of a subsidy in the Subsidy Control Bill, as currently drafted, means that Non Domestic Rates Relief must be considered a subsidy if it meets the definition of: a financial contribution (including a tax relief) that is provided by a public authority; a contribution that provides a benefit not available on market terms, which is specific to one or more enterprises; and has, or could have, a distortive effect on competition or investment within the UK, as well as trade or investment between the UK and another country.

The government insists this definition is consistent with the UK's international obligations under the UK/EU Trade and Cooperation Agreement and the World Trade Organisation rules on subsidies.

Raven is adamant that renewables-related rates relief is demonstrably not a subsidy and the legislation should be used to confirm that fact. "If you look at the definition of a subsidy, non-domestic rates relief does not constitute a subsidy," he argued. "It does not impact the market price of power, it does not give an unfair competitive advantage to any one developer, and it does not affect international trade. As such it does not meet the definition of subsidy."

Meanwhile, Hamlyn would like the government to go further and address the root cause of a problem that continues to afflict the entire distributed renewables sector.

"If you have a headache you take pain relief," he explained. "Relief is designed to address a problem that you recognise exists. There is a fundamental problem with the way the rates are calculated. But HMRC has no intention of fixing the current rateable valuation process because they are terrified of losing money. If you addressed the problem at source you wouldn't need relief... The big concern now is revaluations in 2023 could push up rateable values yet again and devalue the relief that is in place.

"What we want to see is an overhaul of the way renewable energy technologies - and specifically hydropower assets - are valued for business rates, as the current approach is not fit for purpose."

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