



The Case for Full Levy Reform:

Quarterly Tracker - Q4 2026

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OCTOBER 2026

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ABOUT THE MCS FOUNDATION

Our vision is that every UK home benefits from being carbon free. The MCS Foundation engages in grants, advocacy, research, and programmes to drive the widespread adoption of renewable energy technologies in UK homes. We were founded in 2018 to oversee the MCS (Microgeneration Certification Scheme), the UK's quality mark for small-scale renewables like solar panels and heat pumps. Since then, we've distributed more than £3 million to organisations across the UK, contributed to the development of ambitious government policies, and overseen record growth in certified renewable installations.

Designed by: Jimmy Davies, JimmyDavies.com

Glossary

Fuel poverty (official definition in England)

A household is considered fuel poor if, after energy costs are deducted, its remaining income falls below the poverty line, and the home has an EPC rating of D–G.

Fuel poverty (National Energy Action definition)

A household is considered fuel poor if it spends more than 10% of its net income on energy costs in order to maintain a satisfactory heating regime.

Heat pump

A low-carbon heating technology that uses electricity to extract heat from the air, ground, or water and transfer it into a building, delivering multiple units of heat for each unit of electricity used.

Net income

Household income after taxes and benefits, representing the amount available for spending on essentials such as energy, housing, and food.

Ofgem

The Office of Gas and Electricity Markets, the independent regulator responsible for protecting consumers and overseeing gas and electricity markets in Great Britain.

Ofgem archetypes

A set of representative household profiles developed by Ofgem to assess how different types of consumers are affected by changes in energy policy, prices, and regulation.

Price cap (Ofgem price cap)

A limit set by Ofgem on the maximum amount suppliers can charge households for energy under default tariffs, based on estimated costs of supplying a typical household.

Seasonal Coefficient of Performance (SCOP)

The average efficiency of a heat pump over an entire heating season, measuring the ratio of useful heat produced to the electricity it consumes. For example, a heat pump with a SCOP of 3 produces 3 kWh of heat for every 1kWh of electricity used.

Social and environmental levies / Policy costs

Charges added to energy bills to fund government schemes supporting decarbonisation, energy efficiency, renewable generation, and assistance for vulnerable households.

Spark gap

The ratio between electricity and gas unit prices, reflecting how much more expensive electricity is than gas per unit of energy.

Standing charge

A fixed daily cost paid by energy consumers regardless of how much gas or electricity they use, covering network and system costs.

Background



THE ISSUE: ELECTRICITY IS TOO EXPENSIVE

The high cost of electricity is contributing to household energy affordability pressures and holding back the transition to clean heat. Electricity remains significantly more expensive than gas per unit, weakening the financial incentive for households to switch from fossil fuel heating to technologies such as heat pumps.



THE PROBLEM WITH THE CURRENT SYSTEM

Social and environmental levies (i.e. policy costs) fund important programmes, including support for vulnerable households, energy efficiency and renewable electricity generation. However, these costs fall disproportionately on electricity bills.

Under the Q4 2026 price cap, policy costs account for around 8% of the final electricity price, compared with 3% for gas. Levies are also collected through bills based on either consumption or a flat charge per customer, rather than household income or ability to pay, meaning lower-income households can contribute a greater proportion of their income.



DESPITE RECENT POLICY CHANGES, FURTHER REFORM IS NEEDED

Recent Government interventions have reduced some of the costs placed on electricity bills. From October 2026, VAT has been removed from household electricity bills, while Government is funding 75% of the domestic share of the Renewables Obligation between 2026/27 and 2028/29. These interventions are temporary and significant policy costs remain on electricity bills.

VAT relief is due to end in March 2027, while the full domestic cost of the Renewables Obligation is currently expected to return to bills from 2029/30. Furthermore, the Office for Budget Responsibility (OBR) predicts that environmental levies will increase from £14bn in 2025-26 to £19bn by 2030-31 – a rise of around a third.¹



THE MCS FOUNDATION'S CALL FOR ACTION

The MCS Foundation is calling for the remaining social and environmental policy costs on electricity to be funded through general taxation. This would make the way these programmes are funded fairer, while improving energy affordability and strengthening the financial case for switching to clean electric heating.



ABOUT THIS QUARTERLY TRACKER

This quarterly tracker uses the latest Ofgem price cap data to monitor electricity and gas prices, policy costs, household affordability and the running-cost case for switching from a gas boiler to a heat pump.

Using the same methodology and Ofgem archetypes² as in our original reports on levy reform,^{3,4} it assesses the impact full levy reform could have on household bills, affordability and the transition to clean heat.



1. assets.publishing.service.gov.uk/media/69a6d7b62e1f4fbd4252208/economic-and-fiscal-outlook-march-2026-web-accessible.pdf

2. www.ofgem.gov.uk/sites/default/files/2024-02/Ofgem_archetypes_update_2024_FinalReport_v4.1.3.pdf

3. mcsfoundation.org.uk/wp-content/uploads/2026/02/MCSF-Rebalancing-Electricity-Levies-in-the-UK-Report-Final.pdf

4. mcsfoundation.org.uk/wp-content/uploads/2026/06/MCSF-The-case-for-further-levy-reform-Report-2026-1.pdf

Key findings

The spark gap has decreased



from **3.56** in Q3 2026
to **3.30** in Q4 2026



**UNDER FULL
LEVY REFORM,**
the spark gap would
reduce even further to

2.96

- The temporary removal of VAT from electricity bills represents a 0.38% reduction in the overall price of electricity. Gas costs on the other hand have risen by 7.89% from last quarter, meaning that the spark gap has decreased.
- However, this headline reduction masks an increase in underlying costs: wholesale electricity costs have risen by 11.7%, contributing to a 4.6% increase in the pre-VAT cost of electricity. The VAT intervention has therefore absorbed this increase; without it, electricity prices would have risen by approximately 4.6%.

Electricity
Price

▼ **0.38%**

Gas
Price

▲ **7.89%**

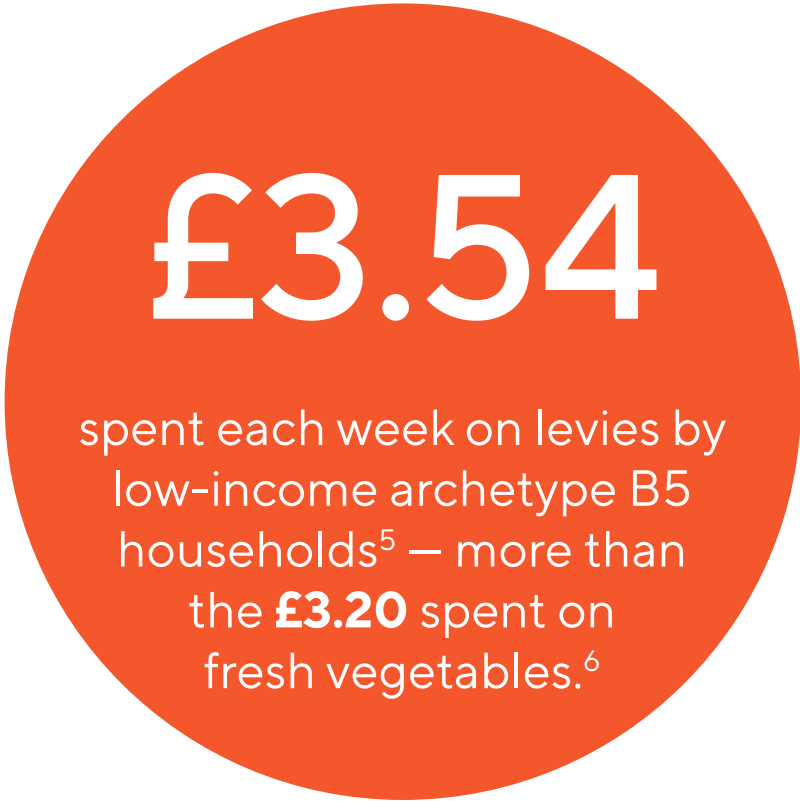
Electricity Price

WITHOUT VAT INTERVENTION

▲ **4.60%**

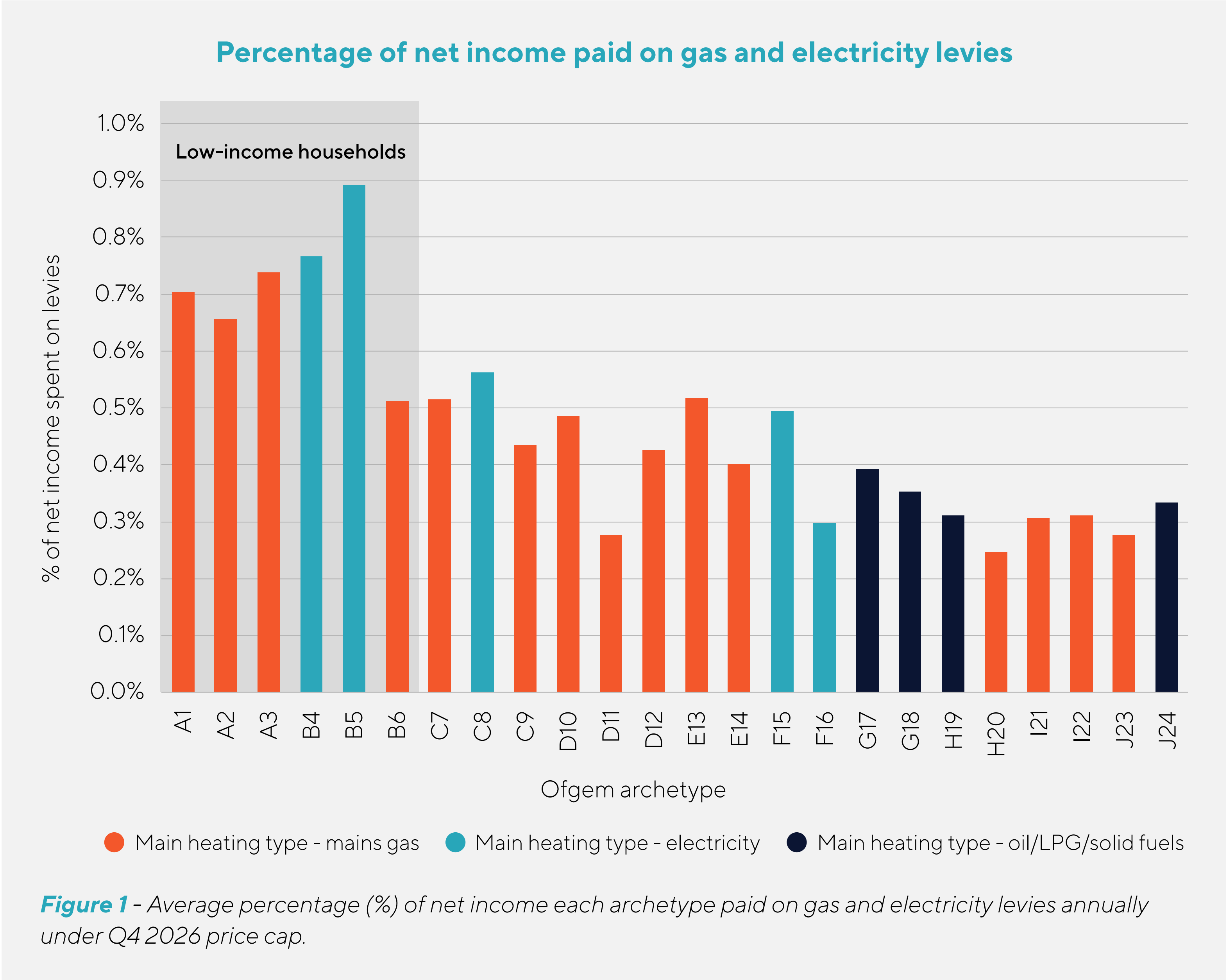
The current levy system is regressive

- ➔ Some low-income households spend more than three times the proportion of their net income on levies than wealthier households.
- ➔ Because most levies remain on electricity bills, electrically heated households and those with higher electricity needs, also bear a disproportionate share of the costs.



5. www.ofgem.gov.uk/sites/default/files/2024-02/Ofgem_archetypes_update_2024_FinalReport_v4.1.3.pdf

6. www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/expenditure/datasets/familyspendingworkbook1detailedexpenditureandtrends (FYE 2025, Tab 3.1)



All households would save money on their energy bills under full levy reform

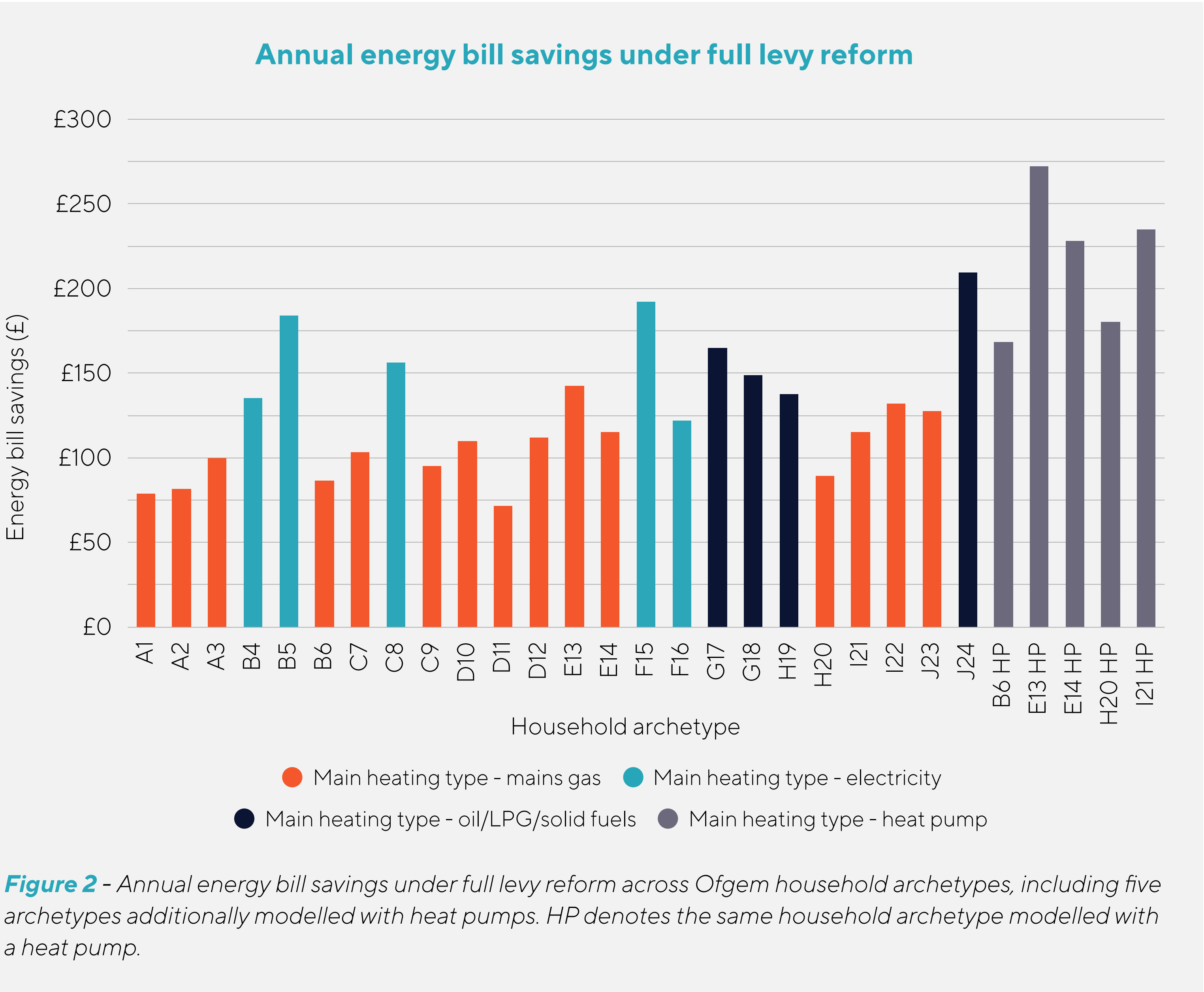
➔ If levies were removed from electricity bills:

The average household could save **£112** per year

Low-income households could save between **£79-£184** per year

Low-income households on direct electric, B4 and B5, could save **£135 and £184** per year

Heat pump users could save between **£168-£272** per year



Low-income households need continued support with energy bills

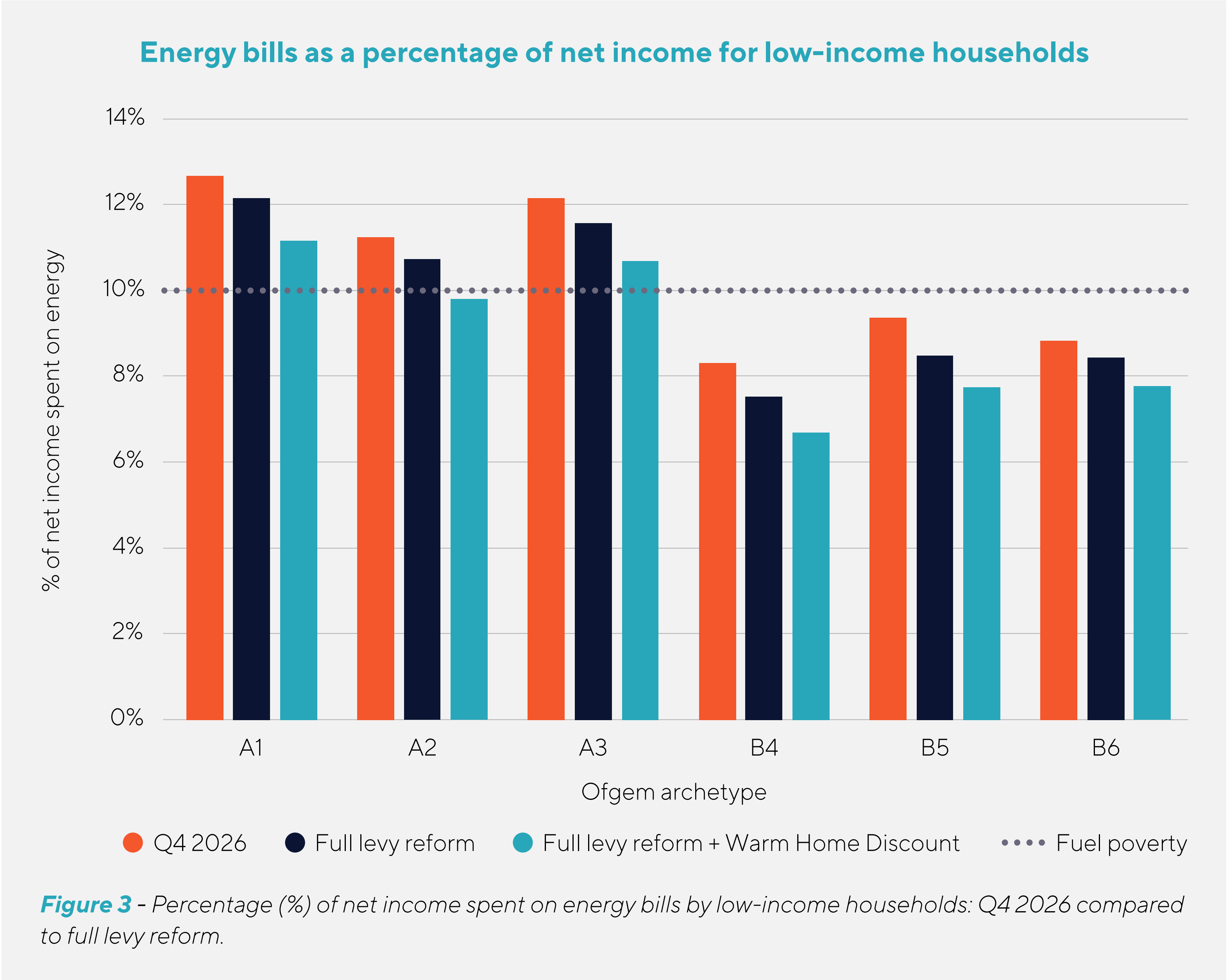
- ➔ Despite the temporary removal of VAT from electricity bills, recent increases in wholesale energy prices mean that three low-income archetypes—A1, A2 and A3—continue to sit above the fuel-poverty threshold.
- ➔ Full levy reform reduces energy costs for low-income households, but targeted support will still be necessary to bring all households out of fuel poverty.

Combining full levy reform with the Warm Home Discount could bring over

868,000

HOUSEHOLDS OUT OF FUEL POVERTY⁷

7. This assumes they are in receipt of the £150 annual Warm Home Discount scheme.



Heat pumps with a SCOP of 2.5 could achieve running cost parity with gas boilers

➔ The temporary removal of VAT from electricity has helped narrow the spark gap, improving heat pump running costs relative to gas boilers compared with Q3.

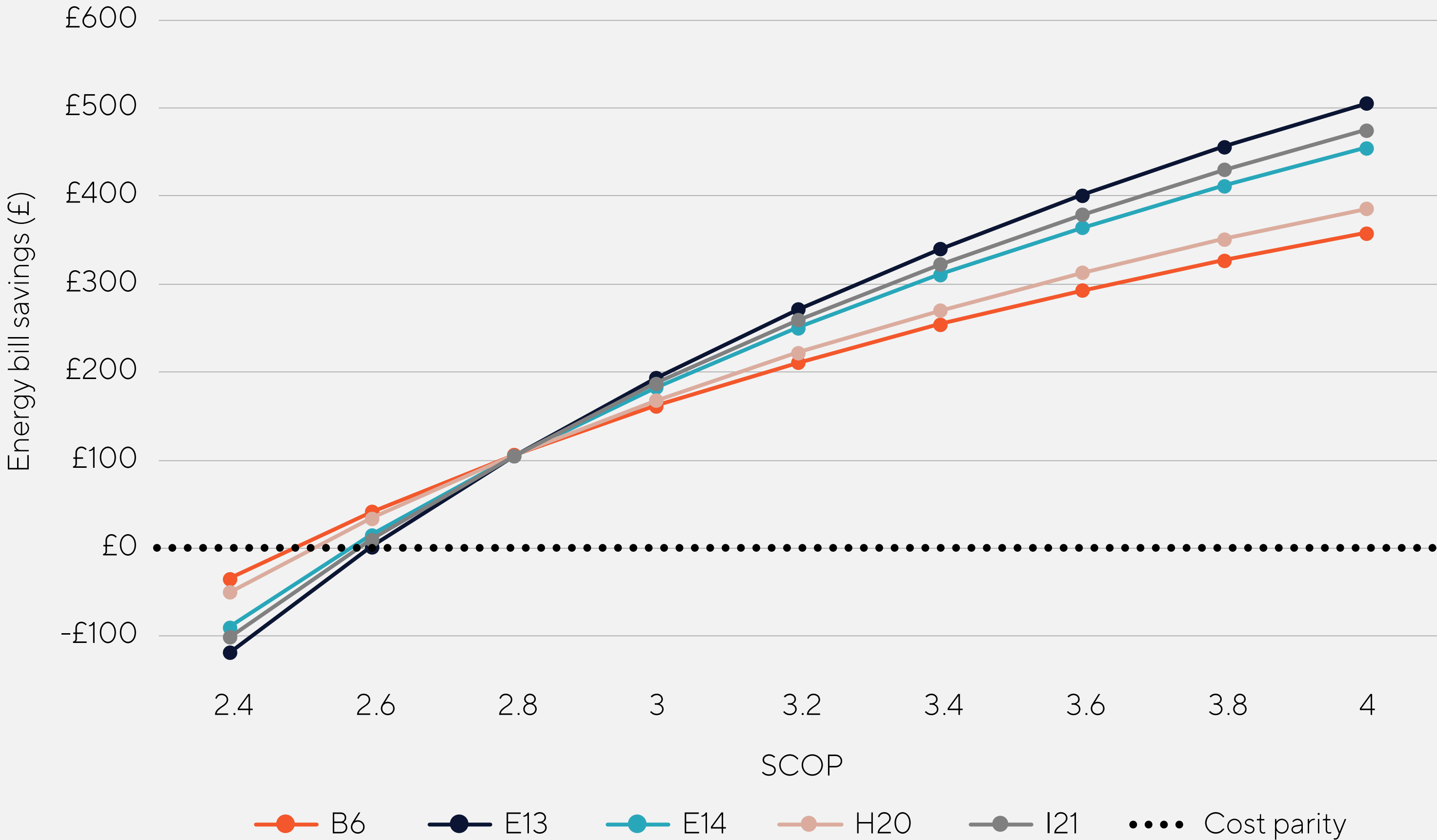


£162-£193 per year at a **SCOP of 3**

£358-£505 per year at a **SCOP of 4**

⚠ However, these heat pump savings should be interpreted with caution. Higher gas prices and the temporary VAT relief have narrowed the spark gap, improving heat pump running costs, but their economics should not depend on elevated gas prices. A durable transition to low-carbon heating requires electricity to remain sustainably cheaper relative to gas.

Annual energy bill savings of a heat pump compared to a gas boiler at different efficiencies

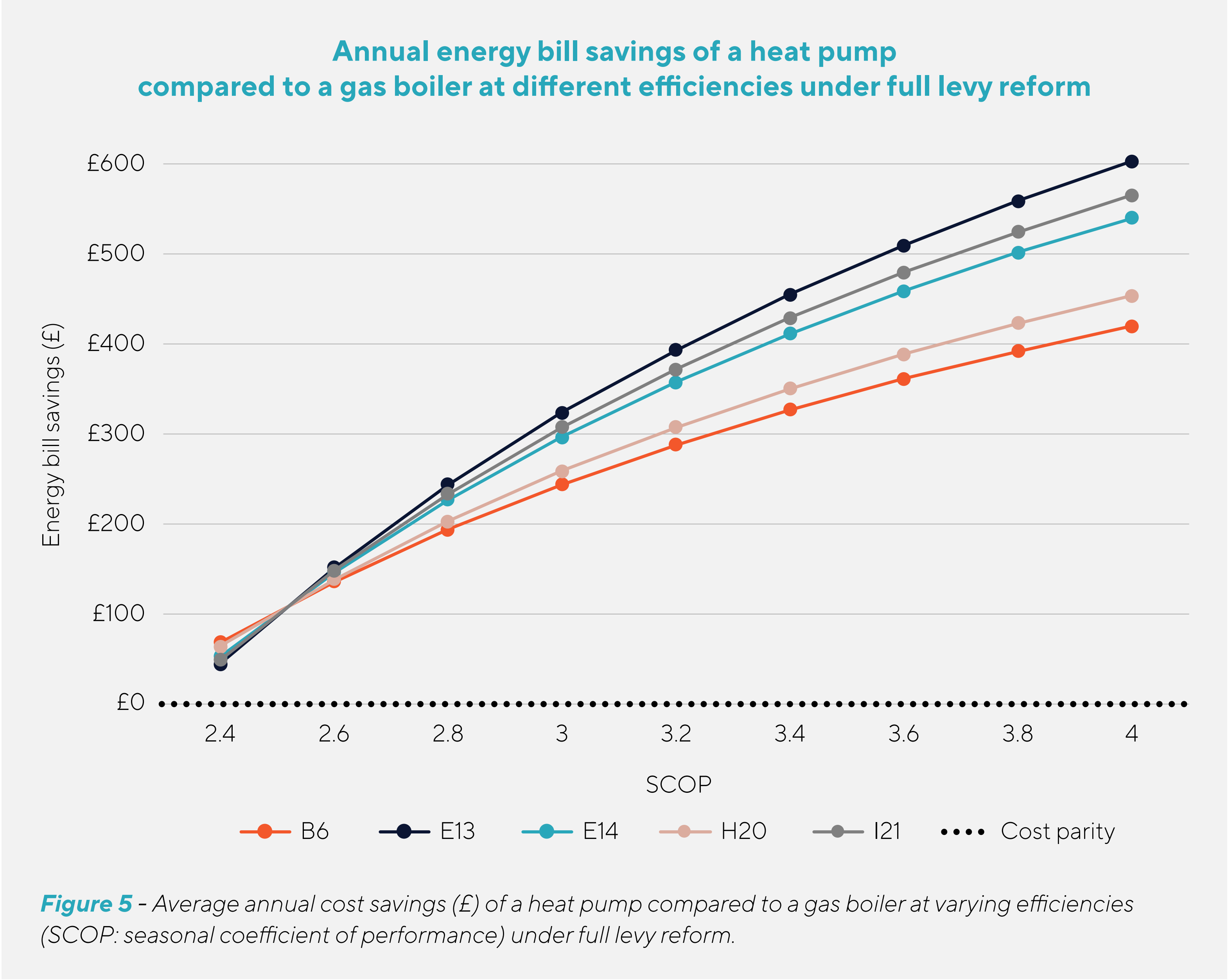
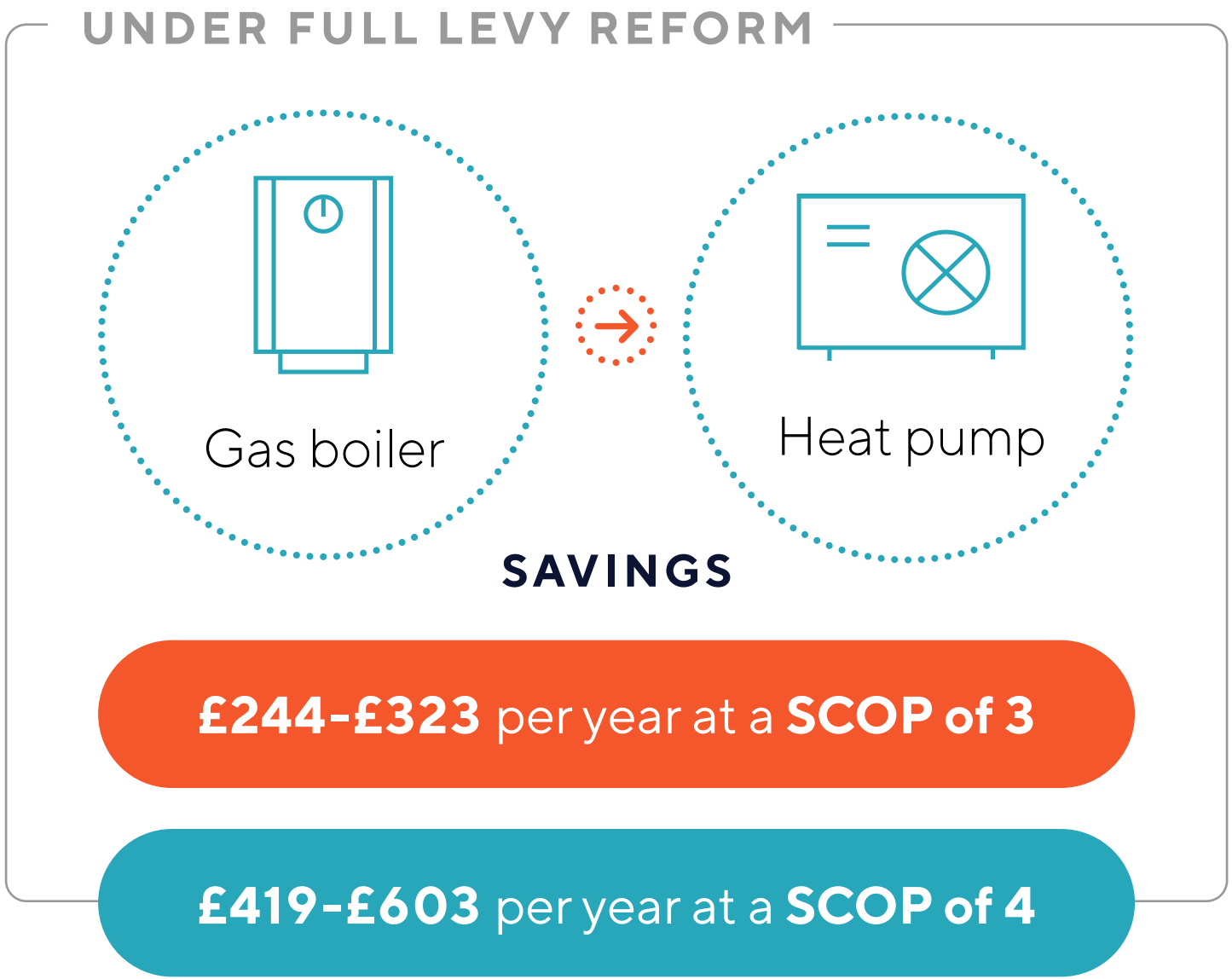


Note: The five archetypes shown in Figures 4–6 are gas-heated households modelled as switching from a gas boiler to a heat pump.

Figure 4 - Average annual cost savings (£) of a heat pump compared to a gas boiler at varying efficiencies (SCOP: seasonal coefficient of performance) under Q4 2026 price cap.

Under full levy reform, heat pumps with a SCOP of 2.3 could achieve running cost parity with gas boilers

- ➔ Full levy reform further improves heat pump running costs relative to gas boilers.
- ➔ Unlike recent improvements driven largely by higher gas prices, levy reform would provide a structural benefit, making heat pump economics less dependent on volatile wholesale gas prices.



Lifetime savings could outweigh the additional upfront cost of a heat pump

- ➔ At a SCOP of 3, switching from a gas boiler to a heat pump could deliver lifetime energy bill savings of £1,990–£2,378 under the Q4 2026 price cap. Under full levy reform, these savings increase to £2,995–£3,975 over 15 years.
- ➔ Under full levy reform, lifetime energy bill savings at a SCOP of 3 could more than offset the remaining upfront cost difference between a heat pump and a gas boiler.
- ➔ For a higher-performing heat pump with a SCOP of 4, lifetime savings under full levy reform could reach £5,157–£7,409.

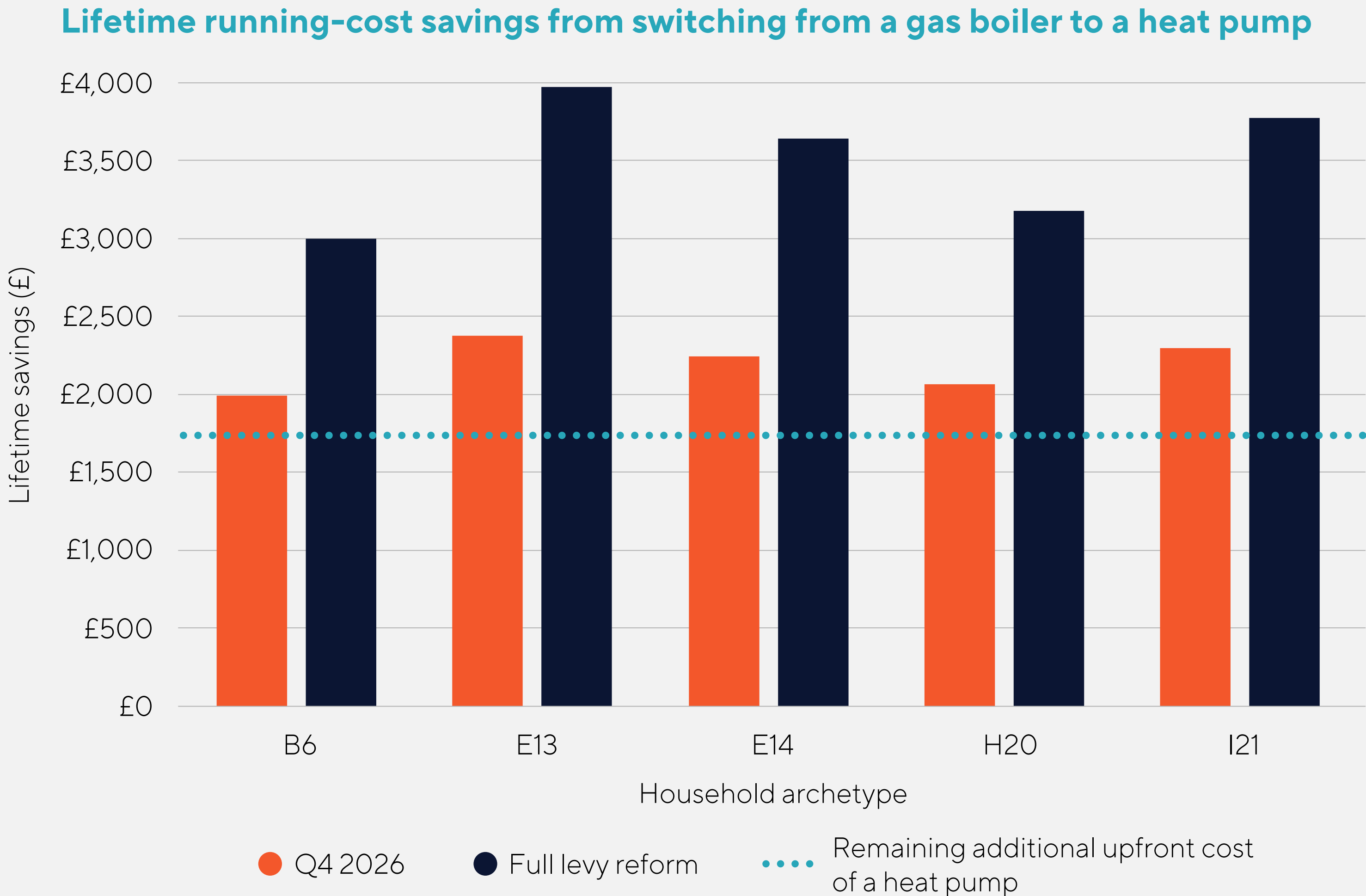


Figure 6 - Lifetime running-cost savings from a heat pump compared with a gas boiler under the Q4 2026 price cap and full levy reform, assuming a SCOP of 3 and a 15-year lifespan. The additional upfront cost of the heat pump is based on an average heat pump installation cost of £13,000, an average gas boiler installation cost of £3,800, and a Boiler Upgrade Scheme grant of £7,500.

Transforming the way
our homes are heated,
cooled and powered

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