EXPLANATORY MEMORANDUM TO THE

OTHER FUEL SUBSTITUTES (RATES OF EXCISE DUTY ETC.) (AMENDMENT) ORDER 2004

2004 No. 2062

1. 1.1 This explanatory memorandum has been prepared by HM Customs and Excise on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

2.1 This Order further amends the Other Fuel Substitutes (Rates of Duty etc.) Order 1995[1] ("the Principal Order"), which prescribes the rates of excise duty charged on certain liquids ("fuel substitutes") under section 6A of the Hydrocarbon Oil Duties Act 1979 (c. 5) ("the Oil Act"). The effect of this Order is to amend the provisions in the Principal Order that set those rates, as a consequence of amendments that have been made to the Oil Act.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 The rates of duty for fuel substitutes are prescribed by the Principal Order, as amended. However, the liability to duty in respect of fuel substitutes is adjusted, with temporary effect, from 1st September 2004 by the Excise Duties (Surcharges or Rebates) (Hydrocarbon Oils etc.) Order 2004 (S.I. 2004/2063) ("the Relieving Order").

3.2 The Relieving Order adjusts several liabilities to duty under the Oil Act in order to negate, with temporary effect, the increases in duty that are made by sections 5 and 7 of the Finance Act 2004 (c. 12). The Relieving Order makes similar provision in respect of the adjustment of liability to duty on fuel substitutes as that made in respect of hydrocarbon oils. For more on the effect of the Relieving Order, please see the explanatory memorandum to that Order, which is also laid before the House of Commons today.

3.3 Given that the Relieving Order adjusts the liability anyway with effect from 1st September 2004, the Treasury could have delayed the making of this Order and used the Relieving Order to bring the liability to duty down to the desired level. If that had been done, the adjustments made by the Relieving Order would have to have been calculated on the basis of the rates set by the Principal Order. However, the Treasury has chosen to reset the rates of duty for fuel substitutes (which is a permanent change) by making this Order as planned, and the temporary adjustment made by the Relieving Order operates on the rates of duty prescribed by the Principal Order, as amended by this instrument.

3.4 This means that persons can see which rates of hydrocarbon oil duty the fuel substitutes rates are "linked" to. Further, the Relieving Order may cease to have effect

[1] S.I. 1995/2716, amended by S.I. 2002/3042.

at short notice: had it affected the liability to duty in respect of fuel substitutes without this Order being made, then this Order could have had to be made at extremely short notice (breaching the "21-day rule"). Instead, this Order is made now, to bring rates of duty for other fuel substitutes into line with the Principal Order, albeit the liability to duty is adjusted by the Relieving Order. When the Relieving Order ceases to have effect, the liability to duty in respect of fuel substitutes will simply be discerned by reference to the Principal Order (as amended), as is normally the case.

4. Legislative Background

4.1 The Principal Order prescribes the rates of duty for fuel substitutes. The precise rates of duty depend on the precise use to which the liquid is put (i.e. what kind of engine), and what hydrocarbon oil it might sensibly be said to be an additive or extender to, or a substitute for.

4.2 As originally enacted, the Principal Order set the rate for fuel substitutes for use in a diesel engine at the rate for heavy oil, the rate for fuel substitutes for use in a leaded petrol engine at the rate for light oil and the rate for fuel substitutes for use in an unleaded petrol engine at the effective rate of duty for unleaded petrol. However, the Oil Act was amended and new differential rates of duty were introduced for ultra-low sulphur diesel ("ULSD")[2] and ultra low sulphur petrol ("ULSP")[3]. The Principal Order was amended by the Other Fuel Substitutes (Rates of Excise Duty etc.) (Amendment) Order 2002 (S.I. 2002/3042) in the light of these changes so that the rates for the relevant fuel substitutes were "tied" to the rates for ULSD and ULSD, which soon replaced ordinary diesel and unleaded petrol as the predominant road fuels in use in the UK.

4.3 Section 7 of the Finance Act 2004 (c.12) amended the Oil Act to provide for new rates of duty for sulphur-free petrol ("SFP") and sulphur-free diesel ("SFD"). The rates were set at what would have been the revalorised rates for ULSP and ULSD. The duty rates for ULSP and ULSD are increased with effect from 1st September 2004 in line with inflation plus half a penny per litre. It is envisaged that, as a result of this duty incentive, SFP and SFP will become the predominant road fuels used in the UK.

4.4 If the current linkage in the Principal Order between the duty rates for ULSD and ULSP and fuel substitutes for diesel and petrol were to remain, then the duty rates for these fuel substitutes would have been unintentionally raised 0.5 penny per litre above the rates of the predominant petrol and diesel fuels for which they will actually be a substitute, additive or extender. This Order corrects that position and ensures that fuel substitutes are dutied at the same rates as SFP and SFD, which will be the predominant diesel and petrol fuels used in the UK.

4.5 The Biofuels and Other Fuel Substitutes (Payment of Excise Duties etc.) Regulations 2004 (S.I. 2004/2065) and the Excise Warehousing (Energy Products) Regulations 2004 (S.I. 2004/2064) which come into force 1st September 2004 and are laid together with this instrument, provide for the administration, collection and warehousing arrangements for fuel substitutes.

[2] A term defined in section 1(6) of the Oil Act, as inserted by section 7 of the Finance Act 1997 (c.16), substituted by section 8 of the Finance Act 1998 (c. 36) and by section 7 of the Finance Act 2004 (c. 12).
[3] A term defined in section 1(3A) of the Oil Act, as inserted by section 5 of the Finance Act 2000 (c.17) and substituted by section 7 of the Finance Act 2004 (c. 12).

4.6 Section 6A of the Oil Act[4] and the Principal Order (as amended) give effect to the second sentence of Article 2(3) of Council Directive 2003/96/EC[5] (of 27th October 2003 restructuring the Community framework for the taxation of energy products and electricity) ("the EPD") in respect of motor fuel substitutes, additives and extenders other than biodiesel (for which, see sections 6AA to 6AC of the Oil Act[6]).

4.7 From 1st January 2005, sections 6AD to 6AF of the Oil Act[7] (not section 6A and the Principal Order (as amended)) will give effect to the second sentence of Article 2(3) of the EPD in respect of bioethanol that is a motor fuel substitute, additive or extender.

4.8 The EPD replaced previous directives that had the same effect (apart from the effect on biodiesel) in this regard. Therefore, no change to UK legislation was necessary to implement Article 2(3) of the EPD in respect of fuel substitutes. However, as a result of the amendments made to the Oil Act by the Finance Act 2004 (c. 12) consequential amendments are required to the Principal Order to enable that Order to continue to implement the EPD in respect of fuels that are not biofuels.

4.8 A transposition note for the EPD can be found in the annex to this memorandum. The EPD was considered by the House of Commons European Scrutiny Committee on 27 November 2002[8] and cleared by sub-Committee A of the House of Lords Select Committee on the European Union by letter dated 5 December 2002 to Dawn Primarolo, Paymaster General, HM Treasury[9].

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 Not Applicable.

7. Policy Background

7.1 This Order is made to ensure that fuel substitutes continue to be taxed at the same rate as the predominant petrol and diesel fuels used in engines in the UK.

7.2 As set out in Section 4, at present, most fuel substitutes used as substitutes for diesel are dutied at the same rate as ULSD and most fuel substitutes for unleaded petrol are dutied at the same rate as ULSP. The Government wishes to ensure that if fuel substitutes are used to power motor vehicles, they are dutied at the same rate as those fuels most commonly used in the UK, for which they are a substitute. The

[4] Section 6A was inserted by section 11(1) of the Finance Act 1993 (c. 34) and amended by section 11 of the Finance Act 2000 (c. 17), section 7(1) of, and paragraph 2 of Schedule 2 to, the Finance Act 2002 (c. 23) and section 12 of the Finance Act 2004 (c. 12).
[5] OJ No L 283, 31.10.2003, p 51.
[6] Sections 6AA to 6AC were inserted by section 5 of the Finance Act 2002. Section 6AA was amended by section 4 of the Finance Act 2003 (c. 14) and sections 5 sand 11 of the Finance Act 2004 (c. 12).
[7] Sections 6AD to 6AF are inserted by section 10(3) of the Finance Act 2004 (c. 12) with effect from 1st January 2005.
[8] 2nd Report of Session 2002-03, HC 63-ii.
[9] Progress of Scrutiny, First Report for Session 2002-03, 9 December 2002, ISBN 010 490192 6.

Government does not wish to tax these fuels at a higher rate, since potentially some of these fuels might be more environmentally beneficial than the fuels for which they are a substitute, additive or extender.

7.3 The Government wishes to move the UK fuels market away from the predominance of ULSP and ULSD towards SFP and SFD, respectively (as set out in Section 4). SFP and SFD offer relatively higher environmental benefits compared to ULSP and ULSD. In order to make this move more attractive to consumers the Chancellor announced as part of Budget 2004 that duty rates for ULSP and ULSD would be increased with effect from 1st September in line with inflation plus half a penny per litre whilst SFP and SFD would be taxed at half a penny per litre less than the ULSP/ULSD rate. The expected policy outcome was that, by early 2005, SFD and SFP would have entirely replaced ULSD and ULSP on forecourts.

7.4 At present, only a tiny number of people in the UK power their cars with fuel substitutes. Essentially this Order seeks to deal with a potential taxation anomaly that would arise from the changeover to use of sulphur-free fuels as the main road fuels in the UK. There has been no interest raised in this issue either by Parliament or the public. The change is required to pre-empt an unforeseen change in duty arising in this area. This would happen because the intended linkage between the duty rate for fuel substitutes and the rate for the main road fuels would be broken. If fuel substitutes were to continue to be taxed at the same rate as ultra-low sulphur fuels they could in effect end up being taxed by reference to a redundant fuel rather than the prevalent sulphur-free fuel rates.

7.5 The Government decided in July 2004 that it would not proceed with the duty changes announced in Budget 2004 and due on 1 September 2004, including those for sulphur-free fuels, and that it would review these in its pre-Budget report later in 2004. Any decisions that might lead to ultra-low sulphur rates rising above sulphur free rates and make the latter the most popular fuels at the pump could have a serious effect on fuel substitutes without the provisions in this Order.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies. If this Order were not made then fuel substitutes would be made relatively more costly and therefore uneconomic to use. This Order ensures that the current position whereby other fuel substitutes are dutied at the same rate as the predominant petrol and diesel fuels used in the UK is retained and users of other fuel substitutes do not face additional costs. Since the Order in effect maintains the current position there are no additional compliance or enforcement costs.

8.2 There is no impact on the public sector.

9. Contact

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ANNEX

Transposition Note for Council Directive 2003/96/EC (the "Energy Products Directive")

Articles	Objectives	Implementation	Responsibility
1	Member states to impose taxation on energy products in accordance with this Directive	This Directive replaces and repeals two earlier Council Directives and gives a unified framework to the treatment of motor and heating fuels. Many of the articles in this Directive are therefore already enacted in UK legislation. Where this is the case this transposition note records that no action is necessary. The Directive brings several new energy products within existing duty suspension arrangements and allows the duty suspended free movement of these products within the EU. No change to the scope of UK legislation, or rates of duties, was necessary to implement the EPD. The Directive introduces new energy products –biodiesel, animal and vegetable fats and methanol intended for use as motor or heating fuel – into duty suspension arrangements. Section 13 of the Finance Act 2004 inserted a new section on warehousing into the Hydrocarbon Oil Duties Act 1979 (the "Oil Act"), allowing the application of duty suspension arrangements to a range of new energy products. These regulations – "The Biofuels and Other Fuel Substitutes (Payment of Excise Duties etc.) Regulations 2004" and "The Excise Warehousing (Energy Products) Regulations 2004" – referred to in this document as "The Regulations", which will come into force on 1 September 2004, regulate the administration and collection of the excise duty charged on biofuels and other fuel substitutes and provide the means for warehousing the new energy products.	Economic Secretary to the Treasury – through new regulations.
Articles	**Objectives**	**Implementation**	**Responsibility**
2	Lists the products to which the Directive applies and provides conditions under which those products are taxed. Also lists products and	Existing UK legislation covers a wide range of these products and their taxable uses, divided between Climate Change Levy and Excise Duties on motor and heating fuels (both administered by Customs and Excise).	As above Policy Responsibility is with Oils Team, Tax Practice, HM Customs & Excise, Ralli Quays,

	uses of those products that the Directive does not apply to.	The changes to UK legislation necessary to fully implement the Directive were limited to the inclusion of new energy products in duty suspension arrangements. Section 13 of Finance Act 2004 incorporated changes to the Oil Act bringing the new energy products into duty suspension arrangements. The Regulations provide the conditions under which these products may be warehoused and charged with duty.	Salford.
2(3)	Ensures that the UK's taxation of energy products in respect of motor fuel substitutes, additives and extenders (other than biodiesel) complies with Community framework for taxation of energy products.	Section 6A of the Oil Act (and the Other Fuel Substitutes (Rates of Excise Duty Etc.) Order 1995, which is most recently amended by the Other Fuel Substitutes (Rates of Excise Duty Etc.) (Amendment) Order 2004) ensure that taxation of these products complies with the Energy Products Directive.	Economic Secretary to the Treasury – through new regulations. Policy responsibility is with Environmental Taxation Development Division, Policy Group, HM Customs & Excise, New Kings Beam House, London
3	Definitions	No action necessary	
4	Minimum levels of Taxation	No action necessary	
5	Differentiated levels of taxation allowed in particular circumstances	No action necessary	
6	Defines how exemptions and reductions may be given	No action necessary	
7	Implementation dates for minimum levels of taxation with particular reference to gas oil, public transport and road user charges	No action necessary	
Articles	**Objectives**	**Implementation**	**Responsibility**
8	Minimum levels of taxation appropriate to various industrial and commercial purposes such as agriculture and stationary motors	No action necessary	
9	Minimum taxation levels for heating fuel	No action necessary	
10	Minimum levels of taxation applicable to electricity	No action necessary	
11	Definition of "business	No action necessary	

	use”		
12	Units of measurement	No action necessary	
13	Value of Euro in determining levels of taxation	No action necessary	
14	Range of exemptions	See below	
Article 14(1)(a)	To exempt from taxation energy products used to produce electricity.	Part 7 of the Biofuels and Other Fuel Substitutes (Payment of Excise Duties etc.) Regulations 2004 provides relief for biofuels used as motor fuel in a generator to produce electricity.	Economic Secretary to the Treasury – through new regulations. Policy responsibility is with Environmental Taxation Development Division, Policy Group, HM Customs & Excise, New Kings Beam House, London
Article 15	Range of exemptions allowable for particular purposes	No action necessary	
Article 16	Range of exemptions and reduced tax rates for certain energy products, including products produced from biomass. Includes requirement for member states to inform the Commission of tax reductions and exemptions applied	No action necessary.	
Article 17	Reduced levels of taxation for heating purposes	No action necessary	
Article 18	Derogations – including expiry of certain derogations on 31 December 2006	No action necessary	
Article 19	Commission powers to grant or revoke derogations	No action necessary	
Articles	**Objectives**	**Implementation**	**Responsibility**
Article 20	Provides for which energy products are to be subject to duty suspension arrangements under Directive 92/12.	Section 13 of Finance Act 2004 incorporated changes to the Oil Act to enable the new energy products to be brought into existing duty suspension arrangements. The Regulations provide the conditions under which these products may be warehoused and charged with duty.	Economic Secretary to the Treasury – through new regulations. Policy Responsibility is with Oils Team, Tax Practice, HM Customs & Excise, Ralli Quays, Salford.
Article 21	Provides for circumstances and events when duty charge is applicable	No action necessary	
Article 22	Allows for tax increases to apply to energy products held in stock	No action necessary	
Article 23	Allows for refunds on	No action necessary	

	contaminated products sent back for recycling		
Article 24	Prevents dual taxation of fuel used for transport between member states	No action necessary	
Article 25	Requirement for annual report of levels of taxation on energy products	No action necessary	
Article 26	Requirement to inform the Commission of measures taken in respect of Articles 5, 14(2), 15 and 17	No action necessary	
Article 27	References to Decision 199/468/EC and adoption of Rules of Procedure	No action necessary	
Articles	**Objectives**	**Implementation**	**Responsibility**
Article 28	Time limits for compliance with this Directive	The Energy Products Directive, 2003/96, came into force on 1 January 2004. The UK legislative timetable has meant that new provisions necessitated by the Directive were presented in the Finance Bill delivered by the Chancellor of the Exchequer to Parliament on 17 March 2004. Existing UK legislation already deals with the taxation of products used, or intended to be used, as motor or heating fuels. No changes to UK legislation were necessary to alter any charging provisions. However, changes were necessary to include the new energy products described in the Directive, in arrangements, to facilitate the duty suspended free circulation of these products. The Commission was aware that	

		member States were unlikely to be able to implement the provisions of the Directive on time because of its late passage through the European Parliament (it was adopted on 27th October 2003 only a few months before it comes into effect). However, a letter of formal notice of infringement has been received. The Commission has been informed of the legislative process that the UK has undertaken and the Regulations accompanying this document fulfil the UK's obligations under the Directive.	
Article 29	Periodic examination of exemptions and minimum levels of taxation	No action necessary	
Article 30	Repeal of Directives 92/81 and 92/82	Reference to these Directives in UK legislation has been changed by section 14 of the Finance Act 2004.	Economic Secretary to the Treasury Policy Responsibility is with Oils Team, Tax Practice, HM Customs & Excise, Ralli Quays, Salford.
Articles	**Objectives**	**Implementation**	**Responsibility**
Article 31	Date of entering into force	See comments at Article 28	
Article 32	Directive addressed to Member States		
Annex I	Minimum levels of taxation applicable to motor fuels	No action necessary	
Annex II	Reduced rates and exemptions from taxation applicable to member states.	No action necessary	